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No. 16050 ✓

United States
Court of Appeals
for the Ninth Circuit

McNEIL CONSTRUCTION COMPANY, a Corporation,

Appellant,

vs.

THE LIVINGSTON STATE BANK, a Corporation,

Appellee.

Transcript of Record

Appeal from the United States District Court
for the District of Montana.

FILED

AUG - 4 1958

PAUL P. O'BRIEN, CLERK

No. 16050

United States
Court of Appeals
for the Ninth Circuit

McNEIL CONSTRUCTION COMPANY, a Corporation,

Appellant,

vs.

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Appellee.

Transcript of Record

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

BROWN, SANDE, SYMMES AND FORBES,
Suite 200, First National Bank Building,
Billings, Montana,

For Appellant.

LUXAN AND SCRIBNER,
322 Fuller Avenue,
Helena, Montana,

For Appellee.

In the United States District Court for the District
of Montana, Billings Division

Case No. 758

McNEIL CONSTRUCTION COMPANY, a Corporation,
Plaintiff,

vs.

THE LIVINGSTON STATE BANK, a Corporation,
Defendant.

COMPLAINT

Plaintiff above named for its complaint herein respectfully alleged as follows:

I.

That at all times herein mentioned the plaintiff, McNeil Construction Co., was and now is a corporation organized and existing under and by virtue of the laws of the state of California; that the defendant, Livingston State Bank, at all times herein mentioned was and now is a corporation organized and existing under and by virtue of the laws of the state of Montana; that the matter in controversy exceeds \$3,000.00, exclusive of interest and costs.

II.

That the defendant is a banking corporation organized and existing as aforesaid, and that it is engaged in the banking business and accepts deposits from individuals and from corporations, and

authorizes such individuals and corporations to draw checks on accounts maintained by such individuals and corporations in its aforesaid bank, which is located in the city of Livingston, Park County, Montana. [1*]

III.

That at all times herein mentioned the plaintiff, McNeil Construction Co. was engaged, amongst other things, in the general construction business, and during the summer and fall of 1956 was engaged in construction work in Yellowstone National Park, Wyoming; and that it maintained in the Livingston State Bank as aforesaid a bank account in excess of \$5,000.00 for the purpose, among other things, of drawing checks thereon to be issued to employees for work, labor, and services performed by employees of said McNeil Construction Co.

IV.

That between September 13, 1956, and September 28, 1956, inclusive, the plaintiff employed one Lex Lamb as a night watchman on the project or work being done by it in Yellowstone National Park as aforesaid; and that unknown to the plaintiff and in September, 1956, said Lex Lamb stole from the plaintiff 400 blank payroll checks numbered 8401 to 8800, inclusive, from the offices maintained by the plaintiff, McNeil Construction Co. in Yellowstone National Park, Wyoming.

*Page numbering appearing at foot of page of original Certified Transcript of Record.

V.

That on or about September 26, 1956, said Lex Lamb forged the plaintiff's name to 29 of the checks stolen by him as aforesaid, each in the sum of \$143.04, and he cashed the same and which checks were paid by the defendant, Livingston State Bank, in the total sum of \$4,148.16, and from funds on deposit with the Livingston State Bank, and which deposit was made by the plaintiff, McNeil Construction Co., and that said Livingston State Bank was advised of the theft of said 400 payroll checks and the forgery of 29 thereof by said Lex Lamb on or about October 26, 1956, which was within 30 days after the discovery by the plaintiff of the [2] forgery of these checks and the receipt of the plaintiff of vouchers showing said payment.

VI.

The defendant refuses to refund to plaintiff said sum of \$4,148.16, which is due and owing to the plaintiff from the defendant.

Wherefore, plaintiff demands judgment against the defendant in the total sum of \$4,148.16 with interest thereon at the rate of 6% from the 1st day of November, 1956, together with the costs and disbursements of this action.

BROWN, SANDE, SYMMES &
FORBES,

/s/ CHARLES B. SANDE,

/s/ WEYMOUTH D. SYMMES,

/s/ ROCKWOOD BROWN, JR.,
Attorneys for Plaintiff.

[Endorsed]: Filed May 1, 1957. [3]

[Title of District Court and Cause.]

MOTION AND NOTICE

Comes now the defendant and moves the Court as follows:

1. To dismiss the action, pursuant to the provisions of Section 1406, Title 28, United States Code, on the ground that said action is filed in the wrong division, because (a) it is a civil action, not of a local nature, against a single defendant, and (b) the defendant resides and maintains its principal place of business in Park County, Montana, in the Helena Division of said Court.

2. To dismiss the action because the Complaint fails to state a claim against the defendant upon which relief can be granted.

3. In the event said action is not dismissed, to transfer said action to the Helena Division of said Court, pursuant to the provisions of Section 1406, Title 28, United States Code, on the ground that said action is filed in the wrong division because (a) it is a civil action, not of a local nature, against a single defendant, and (b) the defendant resides and maintains its principal place of business in Park County, Montana, in said Helena Division.

4. In the event said action is not dismissed, to require the joinder of Seaboard Surety Company as a party plaintiff in said cause, and to summon said Seaboard Surety Company to appear in said action, pursuant to the provisions of Rules 19 and 21, Federal Rules of Civil Procedure, on the ground that said Seaboard Surety [4] Company is the real party in interest and a necessary party plaintiff in said cause, as will more fully appear from the Affidavit of A. W. Scribner, hereto attached and made a part hereof.

This Motion is and will be based upon the records and files in this cause and upon the Affidavit of A. W. Scribner, hereto attached, marked "Exhibit A" and by this reference made a part hereof.

Dated this 27th day of May, 1957.

LUXAN & SCRIBNER,

/s/ A. W. SCRIBNER,

Attorneys for Defendant.

Notice

To McNeil Construction Company, Plaintiff Herein;
Seaboard Surety Company; and to Messrs.
Brown, Sande, Symmes & Forbes, Attorneys
for Plaintiff and for Said Seaboard Surety
Company:

You and each of you will please take notice that the defendant will present the foregoing Motion

and bring the same on for hearing before the above-entitled Court on the next law and motion day to be held by said Court following five (5) days after the service of this Notice.

Dated this 27th day of May, 1957.

LUXAN & SCRIBNER,

/s/ A. W. SCRIBNER,

Attorneys for Defendant. [5]

EXHIBIT A

Affidavit

State of Montana,

County of Lewis and Clark—ss.

A. W. Scribner, being first duly sworn, deposes and says:

1. That he is one of the attorneys for the defendant in the above-entitled cause, and that he makes this Affidavit on behalf of said defendant and in support of the Motion attached hereto.

2. That the defendant is a corporation organized and existing under and by virtue of the laws of the State of Montana and that it maintains its principal place of business in Livingston, Park County, Montana, which, under the provisions of Rule 9-2, Rules of the United States District Court, for the District of Montana, is in the Helena Division of said Court.

That defendant resides in, and is subject to suit and process in, said Helena Division. That the action is not of a local nature, and Affiant knows of no good or sufficient reason why the action should be prosecuted in the Billings Division of this Court.

3. Affiant is informed and believes that, prior to the commencement of this action, the alleged loss claimed by the plaintiff herein, was paid to said plaintiff by Seaboard Surety Company, pursuant to the provisions of a contract of insurance in force between said parties and/or the provisions of an indemnity bond given by said Seaboard Surety Company to the plaintiff, and that by reason thereof, said Seaboard Surety Company became and is subrogated to the claimed rights of the plaintiff, and is the real party in interest and a necessary party plaintiff in this action. Said Seaboard Surety Company is subject to the jurisdiction of this Court as to both service of process and venue and can be made a party plaintiff without depriving the Court of jurisdiction of the parties before it. Affiant is informed and believes that Messrs. Brown, Sande, Symmes & Forbes, the attorneys for plaintiff herein, are also the attorneys for said Seaboard Surety Company, and that [6] said attorneys have been employed by said Seaboard Surety Company to take care of its interests in connection with this action and the matters alleged in the Complaint.

/s/ A. W. SCRIBNER.

Subscribed and sworn to before me this 27th day of May, 1957.

[Seal] /s/ MAUREEN H. CONNOLLY,
Notary Public for the State of Montana, Residing
at Helena, Montana.

My Commission expires April 4, 1959.

[Endorsed]: Filed May 28, 1957. [7]

[Title of District Court and Cause.]

REQUEST FOR ADMISSIONS UNDER RULE
36 OF THE FEDERAL RULES OF CIVIL
PROCEDURE

To the Above-Named Defendant, the Livingston
State Bank, and to Luxon & Scribner, Its At-
torneys,

Sirs:

Please take notice that pursuant to Rule 36 of the Federal Rules of Civil Procedure you are hereby requested within 10 days from the date of service of this request to admit the truth of the facts hereinafter set forth for the purposes of this action only and subject to all pertinent objections to admissibility which may be interposed at trial. Failure to comply will subject you to the penalties of Rule 37 (c) of the Federal Rules of Civil Procedure.

1. That at all times mentioned in the complaint the plaintiff, McNeil Construction Company, was

and now is a corporation organized and existing under the laws of the State of California.

2. That at all times mentioned in the complaint the defendant, The Livingston State Bank, was and now is a corporation organized and existing under and by virtue of the laws of the State of Montana.

3. That on or about October 26, 1956, Mr. Coghlant was an employee of The Livingston State Bank, a corporation.

4. That on or about October 26, 1956, said Mr. Coghlant of The Livingston State Bank placed a telephone call to the plaintiff, McNeil Construction Company, and in the course of the ensuing conversation stated that the defendant had received two checks purportedly drawn by the McNeil Construction Company on The Livingston State Bank, which said Mr. Coghlant thought were forgeries. [8]

5. That on or about October 26, 1956, plaintiff sent to the defendant, The Livingston State Bank, a telegram signed by T. J. O'Hara, McNeil Construction Company, a copy of which is attached hereto as Exhibit A and made a part hereof as if set forth in full, and that said telegram was received by The Livingston State Bank on or about October 26, 1956.

6. That on or about October 26, 1956, the plaintiff, McNeil Construction Company, wrote to The Livingston State Bank at Livingston, Montana, and that annexed hereto as Exhibit B and made a part

hereof as if set forth in full is a true and complete copy of the letter sent to The Livingston State Bank by the McNeil Construction Company, and which was received by The Livingston State Bank on or about October 27, 1956.

7. That on or about October 29, 1956, the defendant, The Livingston State Bank, delivered to agents of the Federal Bureau of Investigation 29 payroll checks drawn on the account maintained by the plaintiff herein in The Livingston State Bank, each of which checks was drawn and payable to the order of one Lex Lamb, and each of which was for the sum of \$143.04, and that upon delivery of said checks to agents of the Federal Bureau of Investigation, said agent or agents of the Federal Bureau of Investigation delivered to The Livingston State Bank a receipt typed on stationery of The Livingston State Bank, Livingston, Montana, dated October 29, 1956, a copy of which is attached hereto as Exhibit C and made a part hereof as if set forth in full.

8. That each of the checks referred to in Exhibit C attached hereto was forged, and that each of said checks was paid by the defendant from funds on deposit with the defendant and which had been deposited by the plaintiff, McNeil Construction Company, and that no part thereof has been refunded to the plaintiff by the defendant.

9. That on or about November 1, 1956, Claude R. Erickson, as president of the defendant, The

Livingston State Bank, wrote to the plaintiff, McNeil Construction Company, and that attached hereto as Exhibit D and made a part hereof as if set forth in full is a true, correct and genuine copy of the letter sent to the plaintiff by the defendant as aforesaid.

10. That on or about November 2, 1956, Claude R. Erickson as president of the defendant, The Livingston State Bank, wrote to the plaintiff, McNeil Construction Company, and that attached hereto as Exhibit E and made a part hereof as if set forth in full is a true, correct, complete and genuine copy of said letter of November 2, 1956.

11. That on or about December 4, 1956, Claude R. Erickson as president of The Livingston State Bank wrote to the plaintiff, and that a true, correct, complete and genuine copy thereof is attached hereto [9] as Exhibit F and made a part hereof as if set forth in full.

12. That from September 13, 1956, to September 28, 1956, one Lex Lamb was employed by the plaintiff, McNeil Construction Company, on construction work being conducted by it in Yellowstone National Park, Wyoming.

13. That subsequently, and on or about February 6, 1957, said Lex Lamb was arrested in Panama City, Florida, by agents of the Federal Bureau of Investigation on a warrant charging him with forging the checks hereinabove referred to.

14. That thereafter said Lex Lamb admitted to agents of the Federal Bureau of Investigation that he stole the payroll checks referred to above from the plaintiff, and that he forged plaintiff's name to 29 of them.

15. That these forged checks were paid by defendant from funds deposited with defendant by plaintiff, and that defendant has not refunded or repaid the same to the plaintiff.

Dated this 29th day of May, 1957.

BROWN, SANDE, SYMMES &
FORBES,

By /s/ WEYMOUTH D. SYMMES,
Attorneys for Plaintiff. [10]

EXHIBIT A

Western Union
Telegram

(Copy)

October 26, 1956.

3:25 p.m.

Livingston State Bank,
Livingston, Montana.

Attention: Mr. C. Coghland:

This is to confirm information given you that payroll checks for our Yellowstone Park job Nos. 8401

to and including 8800, have been stolen. This is our request that you do not honor any payroll checks cleared to your bank in this numerical group.

T. J. O'HARA,
McNeil Construction Co. [11]

EXHIBIT B

McNeil Construction Company
5858 Wilshire Boulevard
Los Angeles 36, California
Canyon Village
Yellowstone Park, Wyoming

October 26, 1956.

Livingston State Bank,
Livingston, Montana.

Attention: Mr. Coghland.

Subject: McNeil Construction Company,
Payroll Checks Nos. 8401-8800, Inclusive.

Dear Sir:

This letter will confirm our conversation over the telephone this morning in which we requested you to stop payment on all checks listed above.

We have notified the Chief Ranger here in the Park this date as to the missing checks, and also the party's name, Lex Lamb, who might possibly be the individual involved in the forging of subject checks.

Any more information that you might obtain on these checks which would be of help to this firm would be greatly appreciated.

Thank you for your help in this matter.

Very truly yours,

McNEIL CONSTRUCTION CO.,

R. H. WESTLUND,

Project Manager. [12]

EXHIBIT C

Livingston State Bank

Livingston, Montana

October 29, 1956.

Received from the Livingston State Bank, McNeil Construction Company Payroll Checks, payable to Lex Lamb, in the amount of \$143.04:

No. 8402—Dated September 26, 1956.

No. 8409—Dated September 26, 1956.

No. 8410—Dated September 26, 1956.

No. 8411—Dated September 26, 1956.

No. 8412—Dated September 26, 1956.

No. 8420—Dated September 25, 1956.

No. 8422—Dated September 25, 1956.

No. 8430—Dated September 26, 1956.

No. 8602—Dated September 25, 1956.

No. 8604—Dated September 26, 1956.

No. 8608—Dated September 25, 1956.

No. 8614—Dated September 25, 1956.

No. 8616—Dated September 25, 1956.

No. 8617—Dated September 25, 1956.

No. 8622—Dated September 26, 1956.

No. 8623—Dated September 26, 1956.

No. 8626—Dated September 26, 1956.

No. 8627—Dated September 26, 1956.

No. 8629—Dated September 26, 1956.

No. 8630—Dated September 26, 1956.

No. 8631—Dated September 26, 1956.

No. 8637—Dated September 26, 1956.

No. 8638—Dated September 26, 1956.

No. 8650—Dated September 25, 1956.

No. 8651—Dated September 25, 1956.

No. 8655—Dated September 26, 1956.

No. 8659—Dated September 26, 1956.

No. 8660—Dated September 26, 1956.

Plus 8656.

(Signature Illegible.) [13]

EXHIBIT D

Livingston State Bank

Livingston, Montana

November 1st, 1956.

McNeil Construction Company,

500 Peruvian Way,

Los Angeles 24, California.

Gentlemen:

Under separate cover we are mailing your statement for the month of October. You will find several checks are not included with this statement and a receipt is enclosed signed by a Special Agent of the Federal Bureau of Investigation. The checks listed on the receipt have been taken by the Agent to help in their efforts to apprehend the person who they believe stole the checks reported as having been taken from your office at Canyon.

We have reported this to the Insurance Company that carries our Blanket bond and they, undoubtedly, will be checking with you to see what various insurance coverage you may carry to determine who has primary coverage.

One of your checks that came into the Bank last Friday looked a little suspicious so we called your Canyon office and were advised at that time about the missing checks.

I might add that the person who is negotiating these checks certainly appears to be an expert as the signatures are very good.

As soon as we hear more we will contact you, however, the discovery of this was so close to the end of the month that we decided to have the Agent from the Federal Bureau of Investigation sign the receipt for the checks so as not to hold up delivery of your statement.

If you have any questions we would be very happy to have you write us.

Very truly yours,

/s/ CLAUDE R. ERICKSON,
CLAUDE R. ERICKSON,
President.

CRE (illegible) [14]

EXHIBIT E

Livingston State Bank
Livingston, Montana

November 2nd, 1956.

McNeil Construction Company,
500 Peruvian Way,
Los Angeles 24, California.

Gentlemen:

We are enclosing herewith one of the checks paid against your account on October 2nd that was reported as being stolen.

We are sending this to you so that you can see the signatures.

Would you please return this to us so that we can also take this check up with our Bonding Company and the Federal Bureau of Investigation?

Very truly yours,

/s/ CLAUDE R. ERICKSON,

CLAUDE R. ERICKSON,
President.

CRE-e

Affidavit of mailing attached.

[Endorsed]: Filed May 29, 1957. [15]

[Title of District Court and Cause.]

DEFENDANT'S RESPONSE TO PLAINTIFF'S
REQUEST FOR ADMISSIONS UNDER
RULE 36 OF THE FEDERAL RULES OF
CIVIL PROCEDURE

To: McNeil Construction Company, Plaintiff, and
to Brown, Sande, Symmes & Forbes, Its At-
torneys:

The Livingston State Bank, a corporation, de-
fendant herein, in response to plaintiff's Request
for Admissions under Rule 36 of the Federal Rules
of Civil Procedure, admits, denies and alleges as
follows:

1. Admits the matters contained in request No. 1.
2. Admits the matters contained in request No. 2.

3. Admits the matters contained in request No. 3, except that the name of the employee referred to is Coghlan.

4. Admits that on or about October 26, 1956, Mr. Coghlan placed a telephone call to the plaintiff and in the course of the ensuing conversation stated that the defendant had received two checks purportedly drawn by the McNeil Construction Company on The Livingston State Bank, but denies that Mr. Coghlan stated that he thought said checks were forgeries.

5. Admits the matters contained in request No. 5.

6. Admits the matters contained in request No. 6.

7. Admits the matters contained in request No. 7.

8. Admits that each of the checks referred to on Exhibit C [17] attached to the request was paid by the defendant from funds on deposit with the defendant which had been deposited by the plaintiff, McNeil Construction Company, and that no part thereof has been refunded to the plaintiff by the defendant. Defendant is unable truthfully either to admit or deny the other statements contained in said request No. 8 for the reason that neither the defendant or any of its agents has any knowledge as to the truth of the facts contained therein and it is impossible for them to secure the necessary information by reasonable inquiry.

9. Admits the matters contained in request No. 9.

10. Admits the matters contained in request No. 10.

11. Admits the matters contained in request No. 11.

12. Admits that one Lex Lamb was employed by the plaintiff for a period after September 13, 1956, on construction work being conducted by it in Yellowstone National Park, Wyoming. Defendant is unable truthfully either to admit or deny that the period of employment covered the dates referred to in said request No. 12 for the reason that neither the defendant nor any of its agents has knowledge as to such facts and that it is impossible for them to secure the necessary information by reasonable inquiry.

13. Admits that subsequently and on or about February 6, 1957, said Lex Lamb was arrested in Panama City, Florida, but denies that said arrest was made by agents of the Federal Bureau of Investigation on a warrant charging him with forging the checks hereinabove referred to.

14. Defendant is unable truthfully either to admit or deny the matters contained in request No. 14 for the reason that neither the defendant nor any of its agents has any knowledge as to the truth of said matters and it is impossible for them to secure the necessary information by reasonable inquiry.

15. Admits that the checks referred to in Exhibit C attached to the request were paid by the

defendant from funds deposited with [18] defendant by plaintiff, and that defendant has not refunded or repaid the same to the plaintiff. The defendant is unable truthfully either to admit or deny whether the checks were forged for the reason that neither the defendant nor any of its agents has any knowledge as to the truth of such statement, and it is impossible for them to secure the necessary information by reasonable inquiry. The only available sources of information, to the knowledge of this defendant, are the plaintiff and its employees.

Dated this 3rd day of June, 1957.

LUXAN & SCRIBNER,

/s/ A. W. SCRIBNER,

Attorneys for Defendant.

State of Montana,
County of Park—ss.

Terry J. Coghlan, being first duly sworn, deposes and says: That he is the Cashier of The Livingston State Bank, a corporation, the defendant in the above-entitled cause, and that he makes this verification as such officer for and on behalf of said corporation; that he has read the foregoing response to Request for Admissions under Rule 36 of the Federal Rules of Civil Procedure, and knows the contents thereof and that the matters and things stated therein are true.

/s/ TERRY J. COGHLAN.

Subscribed and sworn to before me this 6th day of June, 1957.

[Seal] /s/ EDNA M. DUTT,
Notary Public for the State of
Montana.

My Commission expires Feb. 1, 1959.

[Endorsed]: Filed June 10, 1957. [19]

[Title of District Court and Cause.]

MOTION

The plaintiff above named respectfully moves this Court as follows:

1. To grant to the plaintiff in this action summary judgment for the relief demanded in the Complaint. This Motion is based upon the attached affidavits of Lexington Lamb, R. H. Westlund, and Weymouth D. Symmes, together with the plaintiff's request for admissions heretofore served upon the defendant, and upon defendant's response thereto.

BROWN, SANDE, SYMMES &
FORBES,

By /s/ WEYMOUTH D. SYMMES,
Attorneys for Plaintiff. [21]

State of Kansas,
Leavenworth County—ss.

I, Lexington Lamb, having been first duly sworn, state that upon my oath I was employed by the Mc-

Neil Construction Company at Yellowstone National Park in the State of Wyoming during the month of September, 1956. To the best of my recollection I worked as an employee of the McNeil Construction Company for a period of two to three weeks. During that time I was employed by McNeil Construction Company as a night watchman and ambulance driver and switchboard operator. My immediate supervisor was Dick Pierce. My salary was at the rate of \$1.92 per hour and I received my wages in the form of a check with the name of the McNeil Construction Company on it. The McNeil Construction Company withheld from my salary federal income withholding tax, and social security as well as an amount of \$28.00 per week for my room and board. I worked directly under the supervision of McNeil Construction Company personnel, and the equipment that I used to perform my duties was owned by the McNeil Construction Company. I left the employ of the McNeil Construction Company voluntarily by merely leaving the job at the end of one of my regular night shifts, which were from 7:30 p.m. to 7:30 a.m. Prior to leaving the McNeil Construction Company and while I was still on the payroll of the McNeil Construction Company I took a number of Blank checks of the McNeil Construction Company and made out twenty-nine or thirty of them payable to "Lex Lamb" or "William L. Lamb" in the amount of \$143.04 each. I forged the signatures of a Mr. Westland and a Mr. Wilson as the makers of these McNeil Construction Company checks. The day I left the job I cashed the first of

these checks in Canyon Junction, Wyoming. I subsequently cashed the remainder of the checks that I had made up at various other places. I do not claim that any of the money that I received as a result of cashing these checks was legally due me, except that I do claim that when I left the employ of the McNeil Construction Company there was due me \$70.00 to \$80.00 of unpaid wages still owing me which I have not as yet been paid. I make this affidavit at the Federal Penitentiary at Leavenworth, Kansas, where I am presently serving a prison sentence on this 27th day of June, 1957, in the presence of William A. Rundle, Jr., Frank V. O'Brien, and Clara Hebling. I further state that no inducement nor promise or benefit has been extended to me for the making of this affidavit, and I do so voluntarily and of my own free will. I am thirty-one years of age.

Further affiant saith not.

/s/ LEXINGTON LAMB.

Subscribed and sworn to before me this 27th day of June, 1957.

[Seal] /s/ CLARA HEBLING,
Notary Public, Leavenworth
County, Kansas.

My commission expires March 27, 1961. [22]

[Title of District Court and Cause.]

AFFIDAVIT

State of Montana,
Yellowstone National Park—ss.

R. H. Westlund, having been first duly sworn, deposes and says:

1. I am an employee of the McNeil Construction Company, the plaintiff in the above-entitled action, and I was employed as Project Manager by the McNeil Construction Company of certain work being conducted by McNeil Construction Company in Yellowstone National Park, Wyoming, during the month of September, 1956. During that period of time the company maintained offices at or near Canyon Village in Yellowstone National Park. In the construction business there is a rapid turnover of workmen by reason of the fact that most workers employed by construction companies such as plaintiff are transients. This is particularly true when work is being done in a national park such as Yellowstone National Park where there are no permanent residents or inhabitants capable of being hired to do the necessary manual labor. As a consequence, when workmen are employed it is virtually impossible to check upon their back records.

2. On September 13, 1956, an individual [23] calling himself Lex Lamb applied for and was given a position as a laborer by the McNeil Construction Company at its offices in Canyon Village, and he commenced work on September 13, 1956. He had a

Social Security card, and during the period of his employment Social Security as well as federal income tax was taken from his weekly salary.

3. During this period of time all of the McNeil Construction Company payroll checks were kept in a four-drawer file cabinet in the timekeeper's office in Yellowstone National Park. During the daytime when construction work was going on, this office was always occupied by a trusted employee. During the evening and every night, the only access to this office was through a locked door window or a small pass window in the wall which is approximately 1 foot by 2 feet. Lex Lamb was employed by us from September 13, 1956, through September 28, 1956.

4. On October 26, 1956, we received a telephone call from Coghlan, an employee of the defendant, The Livingston State Bank, in which he advised us that he had two payroll checks which he "thought" were forgeries. This call was received in the morning on October 26, 1956. Upon receiving this call we made an immediate check of our existing checks, and found one package of checks was missing which included check Nos. 8401 to 8800. This was the first notice we had that our printed payroll checks had been stolen. We immediately issued a stop payment on this group of checks to the bank in a letter of the same date. We also notified the Park Rangers, who in turn notified the Federal Bureau of Investigation. The reason we did not miss the checks before we were notified by the bank is that there are a number of packages of checks in numerical order stacked on top of the packages of checks

which were stolen, and as we had not reached check No. 8400 in the course [24] of our business operations and there was no reason to suspect that these payroll checks had been stolen.

5. All reasonable precautions were taken by the McNeil Construction Company to avoid the theft of anything located in the timekeeper's office, including payroll checks. Likewise, we did everything that was reasonably possible to employ only honest and trusted individuals. We have been advised by the Federal Bureau of Investigation that as a result of their inquiry they are convinced that the checks were stolen by Lex Lamb during the period of his employment, and I also am advised that an affidavit has been obtained by the plaintiff's attorneys from Lex Lamb in which he admits stealing these payroll checks during the period of his employment by McNeil. A total of 29 of these checks forged by Lex Lamb as aforesaid each in the amount of \$143.04 were honored by the defendant, The Livingston State Bank, from funds plaintiff had on deposit with that bank and plaintiff has not been reimbursed therefor.

/s/ R. H. WESTLUND.

Subscribed and sworn to before me this 15th day of July, 1957.

[Seal] /s/ FRED T. BURKE,

Notary Public for the State of
Montana.

My commission expires October 21, 1957. [25]

[Title of District Court and Cause.]

AFFIDAVIT

State of Montana,
County of Yellowstone—ss.

Weymouth D. Symmes, having been first duly sworn, deposes and says:

1. Deponent is an attorney at law and a member of the law firm of Brown, Sande, Symmes & Forbes, attorneys for the plaintiff in this action. This affidavit is submitted in support of the plaintiff's application for summary judgment, and is submitted with the affidavit of Lexington Lamb and R. H. Westland submitted herewith. This affidavit is executed by deponent because he is personally familiar with the facts hereinafter set forth and has in his possession the original checks hereafter more specifically referred to which will be offered in evidence in the course of the hearing of this motion.

2. As more fully appears in the annexed affidavit of Lexington Lamb and Mr. Westland of the McNeil Construction Co., Mr. Lamb was employed by the McNeil Construction Co. during the month of September, 1956, and at the time he was employed he stole a number of payroll checks from the offices of the McNeil Construction Co. Twenty-nine of these checks were cashed by him and were honored by the defendant, [26] Livingston State Bank; each check was in the sum of \$143.04.

3. The first check which was received by the Livingston State Bank was check No. 8650 and it was dated September 25, 1956. It recited that the payee's badge number was 77631 and that it was for the pay period ending "9-26-56." This check was payable to the order of "Lex Lamb" for \$143.04 and was endorsed by Lex Lamb and evidently cashed at Bedeman's Conoco Service, Livingston, Montana. It was received by the Livingston State Bank on or before October 1, 1956, and was stamped "paid" on "10-1-56."

4. The next day and on October 2, 1956, the Livingston State Bank received three identical checks, each payable to Lex Lamb, each in the sum of \$143.04, each dated September 25, 1956, except one which was dated September 26, 1956, and each recited on their face that they were for the pay period ending "9-26-56," each check was endorsed by "Lex Lamb," one of which was ultimately submitted for deposit to the National Park Bank of Livingston, Montana, one to the Security Trust & Savings Bank of Billings, Montana, and one was evidently cashed directly at the Livingston State Bank for it bears only the endorsement of "Lex Lamb." Each check was stamped "paid 10-2-56."

5. On October 3, 1956, eight of these checks cleared through the Livingston State Bank and each were marked paid on the same date; each was dated September 26, 1956, each was payable to the order

of Lex Lamb, and each was for the pay period ending "9-26-56."

6. On October 4, 1956, six checks were stamped paid by the Livingston State Bank on "10-4-56"; each was payable to the order of Lex Lamb in the sum of \$143.04, each was for the pay period ending "9-25-1956." On October 5, 1956, three checks identical to the checks described in the previous [27] sentence were stamped "paid" by the Livingston State Bank; each was for \$143.04, each was payable to the order of Lex Lamb, and each was for the pay period ending "9-26-1956." On October 6, 1956, three more checks were stamped paid by the Livingston State Bank, each payable to Lex Lamb, each for \$143.04, and each for the pay period ending "9-26-1956." On October 9, 1956, four checks, each payable to Lex Lamb, each for \$143.04, and each for the pay period ending "9-26-1956" were stamped paid by the Livingston State Bank. The 29th check deponent does not have in his files and is not certain as to when that check was cashed.

7. In any event, it is submitted that the receipt and payment of 29 checks over a short period of time, each for the identical pay period and each payable to the same payee shows a gross and careless disregard of the property rights of the plaintiff. Each of these checks were forged as more particularly appears in the annexed affidavit of Lex Lamb.

/s/ WEYMOUTH D. SYMMES.

Subscribed and sworn to before me this 19th day of August, 1957.

[Seal] /s/ CHARLES B. SANDE,
Notary Public for the State
of Montana.

My Commission expires February 7, 1958.

Affidavit of mailing attached.

[Endorsed]: Filed August 19, 1957. [28]

[Title of District Court and Cause.]

AFFIDAVIT IN OPPOSITION TO MOTION
TO ADD SEABOARD SURETY COMPANY
AS A PARTY

State of Montana,
County of Yellowstone—ss.

Weymouth D. Symmes, having been first duly sworn, deposes and says:

1. I am an attorney at law and a member of the firm of Brown, Sande, Symmes & Forbes, attorneys for the plaintiff in the above-entitled action. I submit this affidavit in opposition to the defendant's application for an order requiring that Seaboard Surety Company be added as a party plaintiff to this action. The reason this affidavit is submitted by your deponent rather than the plaintiff is that the plaintiff has no officer or official in Yellowstone County, Montana, qualified to execute an affidavit. In addition to the foregoing, deponent personally

participated in the matters hereafter set forth and is acquainted with the facts hereinafter set forth of his own knowledge.

2. Although Seaboard Surety Company issued an indemnity bond on behalf of the plaintiff, McNeil Construction Company, no payment has been made by Seaboard Surety Company pursuant to the terms of said bond. On the contrary, annexed hereto as Exhibit A and made a part hereof as if set forth in full is a copy of the statement of claim filed by McNeil [30] Construction Company with the Seaboard Surety Company. Annexed hereto as Exhibit B and made a part hereof as if set forth in full is a loan receipt agreement made by McNeil Construction Company to the Seaboard Surety Company. Other than as therein specifically provided, no money has been paid by Seaboard Surety Company to the McNeil Construction Company for the loss more particularly referred to in the complaint on file herein. Under the circumstances, it is respectfully submitted that Seaboard Surety Company is not a proper party to this action, and that it should not be made a party hereto.

3. The position of both Seaboard Surety Company and the plaintiff in this action is that primary liability for the cashing of the 29 forged checks by The Livingston State Bank rests solely and exclusively with The Livingston State Bank and its bonding company, which I am informed and believe and therefore allege is the St. Paul Indemnity Co.

/s/ WEYMOUTH D. SYMMES.

Subscribed and sworn to before me this 22nd day of August, 1957.

[Seal] /s/ ROCKWOOD BROWN, JR.,
Notary Public for the State
of Montana.

My commission expires Sept. 14, 1957. [31]

EXHIBIT A

Seaboard Surety Company
New York, N. Y.

Statement of Claim

Claim is presented by McNeil Construction Co. for loss resulting from default under Bond No. RLA 11514 dated Aug. 4, 1956-Aug. 4, 1959, in the amount of \$10,000.00 on behalf of Lex Lamb employed in the position former employee at Yellowstone Park, Wyoming.

Detailed Statement of Claim

400 payroll checks were stolen from the job office of McNeil Construction Co. at Canyon Village, Yellowstone Park, Wyoming. 29 of these checks, in the sum of \$143.04 each, were subsequently forged and cashed at the Livingston Bank, Livingston, Montana, by Lex Lamb, a former employee.

EXHIBIT B

Loan Receipt

Received from the Seaboard Surety Company (hereinafter referred to as "Company") the sum of Four Thousand One Hundred Forty-eight Dollars and Sixteen Cents (4,148.16) Dollars as a loan, without interest, repayable only in the event and to the extent of any net recovery the undersigned may make from any person, persons, corporation or corporations, or other parties, causing or liable for the loss or damage described in the attached "Statement of Claim" incorporated herein, by reference or from any insurance, and as security for such repayment the undersigned hereby pledges to the said Company all of his, its or their claim or claims against said person, persons, corporation or corporations or other parties, or from any insurance carrier or carriers.

The undersigned covenants that no settlement has been made by the undersigned with any person, persons, corporation or corporations, or other parties, against whom a claim may lie, and no release has been given to anyone responsible for such loss and that no settlement will be made, nor release given without written consent of the said Company; and the undersigned (McNeil Construction Co.) covenants and agrees to co-operate fully with the said Company to permit it, at its own expense, to promptly present claim and, if necessary to likewise

permit it at its own expense to commence, enter into and prosecute suit in the undersigned name against each person or persons, corporation or corporations, or other parties, through whose negligence or other fault the aforesaid loss was caused, or who may otherwise be responsible therefor, with all due diligence, in his, its or their own name.

In further consideration of said advance, the undersigned guarantee(s) that he, it or they are entitled to recover upon said claim for loss or damage, and hereby appoint(s) the [33] managers and/or agents of the said Company and their successors severally, his, its or their agent(s) and attorney(s)-in-fact, with irrevocable power to collect any such claim or claims, and to begin, prosecute, compromise or withdraw in his, its or their name, but at the expense of the Company, any and all legal proceedings that the said Company may deem necessary to enforce such claim or claims, and to execute in the name of the undersigned, any documents that may be necessary to carry the same into effect for the purposes of this agreement. Otherwise the Company shall have final authority over legal proceedings and no settlement or compromise decision or action shall be made without the express consent of the Company or its agents.

In Witness Whereof, McNeil Construction Co. has hereunto set its hand and seal this 10th day of April, 1957.

McNEIL CONSTRUCTION CO.,

By F. M. FRANZ,
Gen. Mgr.

In Presence of:

(Signature illegible).

State of California,
County of Los Angeles.

On the 10th day of April, 1957, personally appeared before me, to me known to be the individual described in, and who executed the foregoing instrument, and acknowledged that he executed the same.

[Seal] KATHLEEN M. WRIGHT,
Notary Public.

My Commission Expires September 15, 1957.

Affidavit of mailing attached.

[Endorsed]: Filed August 22, 1957. [34]

[Title of District Court and Cause.]

AFFIDAVIT

State of Montana,

County of Lewis and Clark—ss.

A. W. Scribner, being first duly sworn, deposes and says:

He is one of the attorneys for the defendant in the above-entitled cause and he makes this Affidavit for and on behalf of said defendant and in opposition to the plaintiff's Motion for Summary Judgment on file herein.

Affiant further states that Summons and Complaint in the above action were served upon the defendant on the 14th day of May, 1957, and that within twenty (20) days thereafter as provided by law the defendant served upon the plaintiff and filed herein its Motion requesting the Court as follows:

1. To dismiss the action, pursuant to the provisions of Section 1406, Title 28, United States Code, on the ground that said action is filed in the wrong division, because (a) it is a civil action, not of a local nature, against a single defendant, and (b) the defendant resides and maintains its principal place of business in Park County, Montana, in the Helena Division of said Court.

2. To dismiss the action because the Complaint

fails to state a claim against the defendant upon which relief can be granted.

3. In the event said action is not dismissed, to transfer said [36] action to the Helena Division of said Court, pursuant to the provisions of Section 1406, Title 28, United States Code, on the ground that said action is filed in the wrong division because (a) it is a civil action, not of a local nature, against a single defendant, and (b) the defendant resides and maintains its principal place of business in Park County, Montana, in said Helena Division.

4. In the event said action is not dismissed, to require the joinder of Seaboard Surety Company as a party plaintiff in said cause, and to summon said Seaboard Surety Company to appear in said action, pursuant to the provisions of Rules 19 and 21, Federal Rules of Civil Procedure, on the ground that said Seaboard Surety Company is the real party in interest and a necessary party plaintiff in said cause, as will more fully appear from the Affidavit of A. W. Scribner, hereto attached and made a part hereof.

Attached to and made a part of the aforesaid Motion was an Affidavit made and executed by A. W. Scribner, Affiant herein, setting forth facts in support of the defenses raised. The aforesaid Motion and supporting Affidavit are hereby expressly referred to and by this reference incorporated herein and made a part hereof.

The aforesaid Motion is still pending before this Court and has not previously been submitted because the Court has not held a law and motion calendar since the date that said Complaint was filed. For these reasons the defendant has not filed a responsive pleading in said cause and has not had occasion to meet the factual issues raised by plaintiff's Complaint or to interpose affirmative defenses thereto.

The above-entitled cause has been pending for only about three (3) months, and only six (6) days have elapsed since the date of service of said Motion for Summary Judgment, and for these reasons neither defendant nor its counsel have had sufficient time in which to secure affidavits, utilize the discovery procedures, or otherwise obtain opposing evidence. Furthermore, much of the information [37] upon which the defense of this case is based is within the exclusive knowledge of the plaintiff or its agents, and must, therefore, be acquired by the testimony of adverse witnesses. In view of the foregoing, it is impossible at this time for the defendant to produce affidavits of persons with personal knowledge of the facts essential to establish its affirmative defenses to said Complaint. However, Affiant states of his own knowledge that the defendant intends to raise the following defenses in its responsive pleading, if a responsive pleading becomes necessary, in addition to the defenses heretofore raised in its Motion to dismiss:

1. That plaintiff herein was guilty of negligence

which was the proximate cause of its loss and which precludes it from setting up the alleged forgery as a claim against the defendant.

2. The real party plaintiff in interest herein, to wit: The Seaboard Surety Company, has indemnified the defendant against any and all liability on account of forged checks drawn on the plaintiff company, and thus has no standing to maintain this action, through its nominal party plaintiff or otherwise.

To substantiate its defense set forth in Paragraph numbered 1, above, the defendant intends to present the following evidence at a trial of this cause, all of which evidence, according to Affiant's best information and belief, is true:

The said Lex Lamb referred to in plaintiff's Complaint was employed by the plaintiff on or about September 13, 1956, at Canyon Village in Yellowstone National Park. Prior to employing the said Lex Lamb the plaintiff made no investigation as to his character or trustworthiness, and made no attempt whatsoever to determine the same. If the plaintiff's employees had made the slightest investigation at said time, they would have discovered (if they did not then know) that the said Lex Lamb was a notorious criminal and a fugitive from justice and that at that time there were two or more warrants outstanding for this man's arrest under the same name upon [38] charges of embezzlement. Not-

withstanding the fact that plaintiff's employees knew, or in the exercise of the slightest precaution should have known, that Lex Lamb was untrustworthy, they hired him without reservation and immediately placed him in the position of night watchman, a position which gave him uncontrolled access to the timekeeper's office and the company files. While so employed the said Lex Lamb took advantage of the opportunity afforded him by the plaintiff's negligence and stole from the plaintiff a block of four hundred (400) numbered payroll checks. Thereafter and about September 27, 1956, the said Lex Lamb left the employment of the plaintiff by simply leaving the job, and without requesting his accrued wages. Although these events should have caused plaintiff's employees to suspect a possible theft, they nevertheless made no investigation to determine whether a theft had been committed. Had they made the slightest investigation, they would have discovered the theft of the payroll checks and thus would have been able to prevent their subsequent negotiation. Although the plaintiff knew or in the exercise of reasonable care should have known that four hundred (400) of its payroll checks were missing or stolen, it nevertheless failed to notify the defendant of that fact and failed to take other steps to prevent their negotiation.

To substantiate its defense set forth in Paragraph numbered 2 above, the defendant intends to present the following evidence at a trial of this cause, all of

which evidence, according to Affiant's best information and belief, is true:

On some date prior to September 13, 1956, the Seaboard Surety Company, the corporation referred to in defendant's Motion, issued to the plaintiff its General Depositor's Forgery Bond, indemnifying the said plaintiff and its depository banks from any and all loss sustained by them as a result of forgery of checks drawn on the plaintiff. The said bond was in full force and effect during all of the times mentioned in plaintiff's Complaint. Neither the [39] defendant nor Affiant has yet had an opportunity to examine the said bond to determine the scope of its provisions, but Affiant is informed and believes that the said bond contained a rider relieving the said Seaboard Surety Company from liability in cases of forgery committed by any employee of the plaintiff. However, the said Seaboard Surety Company is liable in any event because the activities of the said Lex Lamb which gave rise to plaintiff's loss were completed after the said Lex Lamb had left the employment of the plaintiff.

The defendant thus has at least four defenses to said action, two of which were interposed by Motion heretofore filed, and at least two of which it intends to interpose in its responsive pleading and which depend to some extent upon evidence yet to be gathered and introduced in this cause.

Dated this 28th day of August, 1957.

/s/ A. W. SCRIBNER.

Subscribed and sworn to before me this 28th day of August, 1957.

[Seal] /s/ MAUREEN H. CONNOLLY,
Notary Public for the State
of Montana.

My Commission expires April 4, 1959.

[Endorsed]: Filed August 30, 1957. [40]

[Title of District Court and Cause.]

SUPPLEMENTAL AFFIDAVIT IN SUPPORT
OF MOTION FOR SUMMARY JUDGMENT

State of New York,
County of New York—ss.

F. V. O'Brien, having been first duly sworn,
deposes and says:

Deponent is Superintendent of Claims of Seaboard Surety Company, which issued the bonds involved in the above-entitled action. The original bonds which are at the present time in full force and effect and which were in full force and effect during the entire fall of 1956 have been photostated. Attached hereto as Exhibit A and made a part hereof as if set forth in full is a true, correct and complete photostat at the blanket position bond issued by Seaboard Surety Company to McNeil Construction Company. Attached hereto as Exhibit B and made a part hereof as if set forth in full is a true photostatic copy of the depositories forgery bond

issued by Seaboard Surety Company to McNeil Construction Company.

Exhibit A which is the blanket position bond does not underwrite depository banks. It is to be noted that in the first complete paragraph of Exhibit A Seaboard agrees to indemnify McNeil for any loss caused by the theft or other dishonest act of any employee up to \$10,000 "through any fraudulent or dishonest act or acts committed by any one or more of the [41] Employees as defined in Section 3, acting alone or in collusion with others, during the term of this bond as defined in Section 1, or within thirty (30) days after leaving the service of the Insured (except when such leaving is caused by application of Sections 11 or 12)."

The claim filed by the McNeil Construction Company with Seaboard Surety Company for the fraudulent transactions of Lex Lamb was made under Exhibit A, the blanket position bond. The loan receipt agreement executed by McNeil Construction Company to the Seaboard Surety Company was made through the blanket position bond. It is under this bond that this particular claim is based.

/s/ F. V. O'BRIEN.

Subscribed and sworn to before me this 4th day of September, 1957.

[Seal] /s/ BETTY C. RODE,

Notary Public for the State
of New York.

My commission expires March 30, 1958. [42]

EXHIBIT A

Bond No. F—RLA 11514

Seaboard Surety Company
Home Office New York

Blanket Position Bond

In consideration of an agreed premium, Seaboard Surety Company, a corporation of the State of New York, with its Home Office in the City of New York, hereinafter called Underwriter, hereby agrees to indemnify McNeil Construction Co., of 5858 Wilshire Boulevard, Los Angeles, California, hereinafter called Insured, against any loss of money or other property, real or personal (including that part of any inventory shortage which the Insured shall conclusively prove has been caused by the fraud or dishonesty of any Employee or Employees) belonging to the Insured, or in which the Insured has a pecuniary interest, or for which the Insured is legally liable, or held by the Insured in any capacity whether the Insured is legally liable therefor or not, which the Insured shall sustain and discover as provided in Section 2, the amount of indemnity on each of such Employees being Ten Thousand and no/100 Dollars (\$10,000.00) through any fraudulent or dishonest act or acts committed by any one or more of the Employees as defined in Section 3, acting alone or in collusion with others, during the term of this bond as defined in Section 1, or within thirty (30) days after leaving the service

of the Insured (except when such leaving is caused by application of Sections 11 or 12.

Indemnity Against Loss Under
Prior Bond or Policy

If the coverage of this bond is substituted for any prior bond or policy of insurance carried by the Insured or by any predecessor in interest of the Insured which prior bond or policy is terminated, canceled or allowed to expire as of the time of such substitution, the Underwriter agrees to indemnify the Insured against loss of money or other property, as aforesaid sustained by the Insured and discovered as provided in sub-section (b) of Section 2 and which would have been recoverable by the Insured or such predecessor under such prior bond or policy except for the fact that the time within which to discover loss thereunder had expired; Provided: (1) the indemnity afforded by this paragraph shall be a part of and not in addition to the amount of coverage afforded by this bond; and (2) such loss would have been covered under this bond, had this bond with its agreements, limitations and conditions as of the time of such substitution been in force when the acts or defaults causing such loss were committed; and (3) recovery under this bond on account of such loss shall in no event exceed the amount which would have been recoverable under this bond, in the amount for which it is written as of the time of such substitution, had this bond been in force when such acts or defaults were committed, or the amount which would have been recoverable

under such prior bond or policy had such prior bond or policy had such prior bond or policy continued in force until the discovery of such loss, if the latter amount be smaller.

The Foregoing Agreement Is Subject to the Following Conditions and Limitations:

Term of Bond

Section 1. The term of this bond begins with the 4th day of August, 1953, standard time at the address of the Insured above given, and ends at 12 o'clock night, standard time as aforesaid, on the effective date of the cancelation of this bond in its entirety.

Discovery Period

Section 2. Loss is covered under this bond only (a) if sustained through any act or acts committed by any Employee while this bond is in force as to such Employee, subject, however, to the paragraph of this bond entitled Indemnity Against Loss Under Prior Bond or Policy, and (b) if discovered prior to the expiration of twenty-four months from the cancelation of this bond in its entirety as provided in Section 12, or from its cancelation or termination in its entirety in any other manner, whichever shall first happen.

Definition of Employee

Section 3. The word Employee or Employees, as used in this bond, shall be deemed to mean, respec-

tively, one or more of the natural persons (except directors or trustees of the Insured, if a corporation, who are not also officers or employees thereof in some other capacity) while in the regular service of the Insured in the ordinary course of the Insured's business during the term of this bond, and whom the Insured compensates by salary, wages, and/or commissions and has the right to govern and direct in the performance of such service, and who are engaged in such service within any of the States of the United States of America, or within the District of Columbia, the Hawaiian Islands, Alaska, Puerto Rico, the Virgin Islands, Canada or Newfoundland, or elsewhere for a limited period, but not to mean brokers, factors, commission merchants, consignees, contractors, or other agents or representatives of the same general character.

Joint Insured (Not applicable where there is but one Insured)

Section 4. If more than one Insured is covered under this bond, the first named Insured shall act for itself and for each and all of the Insured for all the purposes of this bond. Knowledge possessed or discovery made by any Insured or by any partner or officer thereof shall for the purposes of subsection (a) of Section 11 and Sections 13 and 14 constitute knowledge or discovery by all the Insured and cancelation of this bond as to any Employee as provided in Section 11 shall apply to all the Insured. If, prior to the cancelation or termination of

this bond in its entirety, this bond is canceled or terminated as to any Insured, there shall be no liability for any loss sustained by such Insured unless discovered before the expiration of two years from the time such cancelation or termination as to such Insured becomes effective. The liability of the Underwriter for loss or losses sustained by any or all of the Insured shall not exceed the amount for which the Underwriter would be liable had all such loss or losses been sustained by any one of the Insured. Payment by the Underwriter to the first named Insured of loss sustained by any Insured shall fully release the Underwriter on account of such loss. If the first named Insured ceases for any reason to be covered under this bond, then the Insured next named shall thereafter be considered as the first named Insured for all the purposes of this bond.

Loss Caused by Unidentifiable Employees

Section 5. If a loss is alleged to have been caused by the fraud or dishonesty of any one or more of the Employees, and the Insured shall be unable to designate the specific Employee or Employees causing such loss, the Insured shall nevertheless have the benefit of this bond, provided that the evidence submitted reasonably (in case of inventory shortage, conclusively) establishes that the loss was in fact due to the fraud or dishonesty of one or more of the said Employees, and provided further that regardless of the number of said Employees concerned or implicated in such loss, the aggregate

liability of the Underwriter for any such loss shall not exceed the amount stated in the opening paragraph of this bond applicable to a single Employee. [43]

Merger or Consolidation

Section 6. If any natural persons shall be taken into the regular service of the Insured through merger or consolidation with some other concern, the Insured shall give the Underwriter written notice thereof and shall pay an additional premium on any increase in the number of Employees covered under this bond as a result of such merger or consolidation computed pro rata from the date of such merger or consolidation to the end of the current premium period.

Non-Accumulation of Liability

Section 7. Regardless of the number of years this bond shall continue in force and the number of premiums which shall be payable or paid, the liability of the Underwriter under this bond on account of any one Employee shall not be cumulative in amounts from year to year or from period to period.

Limit of Liability Under This Bond and Prior Insurance

Section 8. With respect to loss or losses caused by any Employee or which are chargeable to such

Employee as provided in Section 5 and which occur partly under this bond and partly under other bonds or policies issued by the Underwriter to the Insured or to any predecessor in interest of the Insured and terminated or canceled or allowed to expire and in which the period for discovery has not expired at the time any such loss or losses thereunder are discovered, the total liability of the Underwriter under this bond and under such other bonds or policies shall not exceed, in the aggregate, the amount carried under this bond on such loss or losses or the amount available to the Insured under such other bonds or policies, as limited by the terms and conditions thereof, for any such loss or losses, if the latter amount be the larger.

Other Insurance

Section 9. If the Insured carries or holds any other insurance or indemnity covering any loss or losses covered by this bond, the Underwriter shall be liable under this bond only for that part of such loss or losses which is in excess of the amount recoverable or recovered from such other insurance or indemnity. In no event shall the Underwriter be liable under this bond for more than the amount of the coverage of this bond applicable to such loss or losses.

Salvage

Section 10. If the Insured shall sustain any loss or losses covered by this bond which exceed the

amount of coverage provided by this bond, the Insured shall be entitled to all recoveries, except from suretyship, insurance, reinsurance, security and indemnity taken by or for the benefit of the Underwriter, by whomsoever made, on account of such loss or losses under this bond until fully reimbursed, less the actual cost of effecting the same; and any remainder shall be applied to the reimbursement of the Underwriter.

Cancelation as to Any Employee

Section 11. This bond shall be deemed canceled as to any Employee: (a) immediately upon discovery by the Insured, or by any partner or officer thereof not in collusion with such Employee, of any fraudulent or dishonest act on the part of such Employee; or (b) at 12 o'clock night, standard time as aforesaid, upon the effective date specified in a written notice served upon the Insured or sent by mail. Such date, if the notice be served, shall be not less than fifteen days after such service, or, if sent by mail, not less than twenty days after the date of mailing. The mailing by the Underwriter of notice, as aforesaid, to the Insured at its Principal Office shall be sufficient proof of notice.

Cancelation as to Bond in Its Entirety

Section 12. This bond shall be deemed canceled in its entirety at 12 o'clock night, standard time as aforesaid, upon the effective date specified in a written notice served by the Insured upon the

Underwriter or by the Underwriter upon the Insured, or sent by mail. Such date, if the notice be served by the Underwriter, shall be not less than thirty days after such service, or, if sent by the Underwriter by mail, not less than thirty-five days after the date of mailing. The mailing by the Underwriter of notice, as aforesaid, to the Insured at its Principal Office shall be sufficient proof of notice. The Underwriter, on request, shall refund to the Insured the unearned premium computed pro rata if this bond be canceled at the instance of the Underwriter or at short rates if canceled or reduced at the instance of the Insured.

Prior Fraud, Dishonesty or Cancellation

Section 13. No Employee, to the best of the knowledge of the Insured, or of any partner or officer thereof not in collusion with such Employee, has committed any fraudulent or dishonest act in the service of the Insured or otherwise.

If prior to the issuance of this bond, any fidelity insurance in favor of the Insured or any predecessor in interest of the Insured and covering one or more of the Insured's employees shall have been canceled as to any of such employees by reason of (a) the discovery of any fraudulent or dishonest act on the part of such employees, or (b) the giving of written notice of cancellation by the insurer issuing said fidelity insurance, whether the Underwriter or not, and if such employees shall not have been reinstated under the coverage of said fidelity insurance

or superseding fidelity insurance, the Underwriter shall not be liable under this bond on account of such employees unless the Underwriter shall agree in writing to include such employees within the coverage of this bond.

Loss—Notice—Proof—Legal Proceedings

Section 14. At the earliest practicable moment, and at all events not later than fifteen days after discovery of any fraudulent or dishonest act on the part of any Employee by the Insured, or by any partner or officer thereof not in collusion with such Employee, the Insured shall give the Underwriter written notice thereof and within four months after such discovery shall file with the Underwriter affirmative proof of loss, itemized and duly sworn to, and shall upon request of the Underwriter render every assistance, not pecuniary, to facilitate the investigation and adjustment of any loss. No suit to recover on account of loss under this bond shall be brought before the expiration of two months from the filing of proof as aforesaid on account of such loss, nor after the expiration of fifteen months from the discovery as aforesaid of the fraudulent or dishonest act causing such loss. If any limitation in this bond for giving notice, filing claim or bringing suit is prohibited or made void by any law controlling the construction of this bond, such limitation shall be deemed to be amended so as to be equal to the minimum period of limitation permitted by such law.

Riders

Section 15. The liability of the Underwriter hereunder is subject to the terms and conditions of the following Riders attached hereto:

The Insured by the acceptance of this bond, gives notice to the Underwriter terminating or canceling prior bond(s) No(s) such termination or cancellation to be effective as of the time this bond becomes effective.

Signed, sealed and dated the 11th day of August, 1953.

SEABOARD SURETY COM-
PANY,

By HOWARD SISKEL,
Attorney in Fact.

(Executed in Duplicate)

337.50 [44]

Excess Indemnity Endorsement

1. It is agreed that, subject to the terms of the bond to which this endorsement is attached, the amount of excess indemnity on the Employees performing the duties of the following positions shall be the amount set opposite the names of such positions, respectively. It is further agreed that the amount of such excess indemnity shall apply only to so much of any loss or losses sustained through any fraudulent or dishonest act or acts committed

after such excess indemnity becomes effective as are in excess of the amount recoverable or recovered on account of such loss or losses under said bond.

2. It is further agreed that the liability of the Underwriter under this endorsement on account of any one Employee in any one or more such positions (in the original or an increased or decreased amount) shall not exceed the largest single amount of indemnity on any one position occupied by such Employee.

3. It is further agreed that no excess losses shall be recoverable under this endorsement unless caused by an Employee who has been identified as having caused such loss, anything to the contrary in said bond or this Endorsement notwithstanding. [45]

EXHIBIT B

Bond No. DF—RLA 11565

Seaboard Surety Company
Home Office New York

Depositors Forgery Bond

In consideration of an agreed premium, Seaboard Surety Company, a corporation of the State of New York, with its Home Office in the City of New York, hereinafter referred to as Underwriter, hereby undertakes and agrees to indemnify those designated

as Insured in Section 10 of this bond to the amount specified therein for losses sustained and discovered as hereinafter set forth through:

Insuring Clauses

1. Forgery or Alteration of, on, or in any check, draft, promissory note, bill of exchange, or similar written promise, order or direction to pay a sum certain in money, made or drawn by, or drawn upon the Insured, or made or drawn by one acting as agent of the Insured, or purporting to have been made or drawn as hereinbefore set forth, including

(a) any check or draft made or drawn in the name of the Insured, payable to a fictitious payee and endorsed in the name of such fictitious payee whether or not such endorsement be a forgery within the law of the place controlling the construction thereof; and

(b) any check or draft procured in a face to face transaction with the Insured or with one acting as agent of the Insured by anyone impersonating another and made or drawn payable to the one so impersonated and endorsed by anyone other than the one so impersonated, whether or not such endorsement be a forgery within the law of the place controlling the construction thereof; and

(c) any payroll check, payroll draft or payroll order made or drawn by the Insured, payable to bearer as well as to a named payee and endorsed by anyone other than the named payee without authority from such payee, whether or not such en-

dorsement be a forgery within the law of the place controlling the construction thereof.

Mechanically reproduced facsimile signatures are treated the same as handwritten signatures.

Indemnity to Depository Banks

2. The Underwriter further agrees to indemnify any bank or banks in which the Insured carries a checking or savings account (each of such banks being hereinafter called Bank) against losses sustained through Forgery or Alteration of, on, or in any of the foregoing instruments made or drawn as hereinbefore set forth and which the Bank shall pay, cash, or take for collection, provided that the liability of the Underwriter for any such losses shall be a part of and not in addition to the amount of insurance applicable to the Insured's office to which such losses would have been allocated had such losses been sustained by the Insured, that losses sustained by the Insured shall be entitled to priority of payment over losses sustained by the Bank, and and that losses under this bond whether sustained by the Insured or the Bank shall be paid directly to the Insured in its own name, except in cases where the Bank shall have already fully reimbursed the Insured for such losses.

Court Costs and Attorneys' Fees

3. If the Insured or the Bank shall refuse to pay any of the foregoing instruments made or drawn as hereinbefore set forth alleging that such instruments are forged or altered, and such refusal shall

result in suit being brought against the Insured or the Bank to enforce such payment and the Underwriter shall give its written consent to the defense of such suit, then any attorneys' fees, court costs, or similar legal expenses incurred and paid by the Insured or the Bank in such defense shall be construed to be a loss under this bond, and the liability of the Underwriter for such loss shall be in addition to any other liability under this bond.

This Bond Covers Losses, as Aforesaid, Sustained
and Discovered as Follows:

1. Sustained by the Insured on or after the date hereof and while this bond is in force.

2. Sustained by the Insured at any time before the termination of this bond as an entirety, which would have been recoverable under the coverage of some similar form of forgery insurance (exclusive of fidelity insurance) carried by the Insured or any predecessor in interest of the Insured, had such prior forgery insurance given all of the coverage afforded under this bond; Provided, with respect to any loss or losses covered by this paragraph, that

(a) the coverage of this bond is substituted on or after the date hereof for such prior forgery coverage and the Insured or such predecessor, as the case may be, carried such prior forgery coverage on the office at which such losses were sustained continuously from the time such losses were sustained to the date the coverage of this bond is substituted therefor; and

(b) at the time of discovery of such losses, the period for discovery of loss under all such prior forgery insurance has expired; and

(c) if the amount of this bond applicable to the office at which such losses were sustained is larger than the amount applicable to such office under such prior forgery insurance at the time such losses were sustained, then liability under this bond for such losses shall not exceed the smaller amount.

3. Losses referred to in paragraphs 1 and 2 immediately preceding must be discovered by the Insured prior to the expiration of twelve months after the termination of this bond as an entirety as hereinafter set forth or its termination in any other manner. [47]

The Foregoing Agreement Is Subject to the
Following Conditions and Limitations:

Exclusion

Section 1. This bond does not cover any loss through Forgery or Alteration of, on, or in registered or coupon obligations issued or purporting to have been issued by the Insured or any coupons attached thereto or detached therefrom.

Joint Insured

(Not applicable where there is but one Insured)

Section 2. If more than one Insured is covered under this bond, the first named Insured shall act for itself and for each and all of the Insured for

all the purposes of this bond. Discovery made by any Insured or by any partner or officer thereof shall for the purpose of Section 9 constitute discovery of all the Insured. If, prior to the termination of this bond in its entirety, this bond is terminated as to any Insured, there shall be no liability for any loss sustained by such Insured unless discovered before the expiration of one year from the time such termination as to such Insured becomes effective. The liability of the Underwriter for loss or losses sustained by any or all of the Insured shall not exceed the amount for which the Underwriter would be liable had all such loss or losses been sustained by any one of the Insured. Payment by the Underwriter to the first named Insured of any loss sustained by any Insured shall fully release the Underwriter on account of such loss. If the first named Insured ceases for any reason to be covered under this bond, then the Insured next named shall thereafter be considered as the first named Insured for all the purposes of this bond.

Non-Reduction of Liability

Section 3. Payment of loss under this bond shall not reduce the liability of the Underwriter under this bond for other losses whenever sustained; Provided, however, that the total liability of the Underwriter under this bond on account of any loss or losses by reason of forgery or alteration committed by any person or in which such person is concerned or implicated, whether such forgery or alteration

involves one or more instruments, is limited to the amount of insurance applicable to the office to which such loss or losses are allocated.

Non-Accumulation of Liability

Section 4. Regardless of the number of years this bond shall continue in force and the number of premiums which shall be payable or paid, the liability of the Underwriter under this bond with respect to any loss or losses specified in the Provided clause of Section 3 of this bond shall not be cumulative in amounts from year to year or from period to period.

Limit of Liability Under This Bond and Prior Insurance

Section 5. With respect to loss or losses set forth in the Provided clause of Section 3 of this bond which occur partly during the period of this bond and partly during the period of other bonds or policies issued by the Underwriter to the Insured or to any predecessor in interest of the Insured and terminated or canceled or allowed to expire and in which the period for discovery has not expired at the time any such loss or losses thereunder are discovered, the total liability of the Underwriter under this bond and under such other bonds or policies shall not exceed, in the aggregate, the amount carried under this bond on such loss or losses or the amount available to the Insured under such other bonds or policies, as limited by the terms

and conditions thereof, for any such loss or losses, if the latter amount be the larger.

Other Insurance or Indemnity

Section 6. This bond shall be primary with respect to any loss or losses covered by this bond and also by any fidelity insurance carried by the Insured or forgery insurance carried by the Bank. This bond shall be excess over any other insurance, security of indemnity applicable to any losses otherwise covered under this bond.

Salvage

Section 7. If the Insured or any Bank shall sustain any loss or losses in excess of the amount of insurance provided under this bond but otherwise covered by the terms of this bond, the Insured or such Bank shall be entitled to all recoveries (except insurance or indemnity held by the Underwriter for its own benefit), less the actual cost of effecting the same, until fully reimbursed, the remainder to belong to the Underwriter.

Termination

Section 8. This bond shall terminate in its entirety—(a) at 12 o'clock night upon the effective date specified in a written notice served by the Underwriter upon the Insured, or sent by mail, and such date, if the notice be served, shall be not less than thirty days after such service, or, if sent by mail, not less than thirty-five days after the date of

mailing, or (b) upon the receipt by the Underwriter of a written request from the Insured to terminate this bond, or (c) immediately upon the taking over of the Insured by a receiver or other liquidator or by State or Federal officials, or (d) immediately upon the taking over of the Insured by another institution. The mailing by the Underwriter of notice, as aforesaid, to the Insured at its Principal Office as designated in this bond, shall be sufficient proof of notice. The Underwriter, on request, shall refund to the Insured the unearned premium computed pro rata if this bond be terminated at the instance of the Underwriter, or if terminated as provided in sub-section (c) or (d) of this Section, or at short rates if terminated or reduced at the instance of the Insured.

Loss—Notice—Proof—Legal Proceedings

Section 9. Upon discovery by the Insured of any fact or circumstance indicating a probable loss under this bond, the Insured shall, as soon as practicable after such discovery, notify the Underwriter in writing at the Underwriter's Home Office, giving all details then known to the Insured. The Insured shall within sixty days after such discovery file with the Underwriter a proof of claim sworn to by the Insured and shall also file the instrument which is the basis of such claim. If, however, it shall be impossible to file such instrument, then the affidavit of the Insured or the Bank setting forth the amount and cause of loss shall be accepted in lieu thereof. Any loss for which the Underwriter may

be liable shall be payable immediately upon receipt by the Underwriter of proof of claim as provided above. No action or proceeding shall be brought against the Underwriter unless begun within one year after the Insured's discovery of loss, except that any action or proceeding to recover under this bond for attorneys' fees, court costs or similar legal expenses incurred and paid in any suit mentioned in Insuring Clause 3 shall be begun within one year from the date upon which the judgment in such suit shall have become final. If any period of limitation contained in this bond is prohibited or made void by any law controlling the construction hereof, such period shall be deemed to be amended so as to be equal to the minimum period of limitation permitted by such law.

Name of Insured—Location—Amount

Section 10. The Insured under this bond are McNeil Construction Co., a partnership composed of Lawrence G. McNeil and Bruce W. McNeil.

Location of Principal Office: 5858 Wilshire Boulevard, Los Angeles, California, and Job Sites.

Amount of Insurance: Twenty-five Thousand and no/100 Dollars (\$25,000.00).

Riders

Section 11. The liability of the Underwriter hereunder is subject to the terms and conditions of the following Riders attached hereto: Rider No. I.

The Insured by the acceptance of this bond, gives

notice to the Underwriter terminating or canceling prior bond(s) No(s)., such termination or cancelation to be effective as of the time this bond becomes effective.

Signed, sealed and dated the 4th day of August, 1953.

SEABOARD SURETY
COMPANY,

By RAY ROSENDAHL,
Attorney-in-Fact.

71.73

[48]

Rider No. I

To be attached to and form part of Depositors Forgery Bond, No. RLA 11565, issued by Seaboard Surety Company, in favor of McNeil Construction Co., and dated August 4, 1953.

In consideration of a reduced premium charged for the attached bond, it is hereby agreed that:

1. Anything in the attached bond to the contrary notwithstanding, the Underwriter shall not be liable under Insuring Clause 1, 2 or 3 of the attached bond on account of any loss or losses by reason of Forgery or Alteration committed by or in collusion with any of the officers or employees of the Insured.

2. The attached bond shall be subject to all of its agreements, limitations and conditions except as herein expressly modified.

3. This rider shall become effective as of the beginning of the 4th day of August, 1953.

Signed, sealed and dated August 4, 1953.

By,

RAY ROSENDAHL,

Attorney in Fact.

Attest:

.....,

MARY CAWLEY. [49]

Selective Branch Office Endorsement

In consideration of the premium charged for this bond, it is hereby agreed that:

1. Anything in this bond to the contrary notwithstanding, the liability of the Underwriter for any loss or losses sustained on account of any instrument covered by this bond made or drawn or purporting to have been made or drawn by or upon the Insured at any office other than its Principal Office, or made or drawn by one acting as agent of the Insured who works out of or is assigned to any office of the Insured other than its Principal Office, shall be limited to the amount set forth opposite such office in the Schedule below, and such amount shall be the limit of the liability of the Underwriter for any such loss or losses resulting from Forgery or Alteration committed by any person or in which such person is concerned or implicated, subject to the provision that, if any such loss or losses are

allocated by the terms hereof to two or more offices, then the limit of liability of the Underwriter as to each such office shall be the amount set forth opposite such office in the Schedule below and the aggregate liability of the Underwriter for all such loss or losses shall not exceed the amount of insurance carried on the Principal Office. The liability of the Underwriter, as set forth herein, shall be a part of and not in addition to the amount of insurance specified in Section 10 of this bond.

2. For all purposes of this bond, the Personal Accounts specifically listed below shall be treated as offices of the Insured and the owners of such Accounts shall be treated as Insured.

Schedule

Amount of Insurance

Blanket Amount—All offices except the
Principal Office and those listed below \$

Offices in selective amounts—

Personal Accounts

\$\$\$
\$\$\$
\$\$\$
\$\$\$
\$\$\$
\$\$\$
\$\$\$
\$\$\$

3. This bond shall be subject to all of its agreements, limitations and conditions except as herein expressly modified.

4. This endorsement shall become effective as of the time this bond is effective.

Signed, sealed and dated the...day of.....,
19.....

SEABOARD SURETY
COMPANY,

By
Attorney-in-Fact.

Affidavit of Mailing attached.

[Endorsed]: Filed September 6, 1957. [50]

[Title of District Court and Cause.]

ORDER

Defendant has moved the court to dismiss (1) on the ground that under the provisions of Section 1406, Title 28, U.S.C. the action is filed in the wrong division, and (2) because the complaint fails to state claim upon which relief can be granted; or, in the event the action is not dismissed, (3) to transfer the action to the Helena Division, and (4) to require the joinder of Seaboard Surety Company as a party

plaintiff. Plaintiff has filed a motion for summary judgment.

Counsel have submitted briefs and oral argument. It is my conclusion that the motion to dismiss should be denied and that the action should be transferred to the Helena Division, for the reasons set forth in the Memorandum filed with this Order.

It Is Hereby Ordered that the defendant's motion to dismiss be, and the same hereby is denied, and the defendant's motion to transfer the action to the Helena Division be, and the same hereby is granted.

It Is Further Ordered that the Clerk of this Court be, and he hereby is directed to transmit the file in this action forthwith to the Helena Division of the above entitled court.

It Is Further Ordered that the Clerk of this Court forthwith notify the attorneys of record for the respective parties of the making of this Order.

Done and dated this 3rd day of October, 1957.

/s/ W. J. JAMESON,
United States District Judge.

[Endorsed]: Filed October 3, 1957. [53]

In the United States District Court for the District
of Montana, Helena Division

No. 758

MCNEIL CONSTRUCTION COMPANY, a Corpo-
ration,

Plaintiff,

vs.

THE LIVINGSTON STATE BANK, a Corpo-
ration,

Defendant.

ORDER

Plaintiff depositor sues to recover the sum of \$4148.16 from the defendant bank which paid said sum out of the plaintiff's account upon forged checks.

Defendant filed a motion to dismiss upon the ground that the said action was filed in the wrong division, a motion to dismiss the action upon the ground the complaint failed to state a claim upon which relief could be granted, a motion to transfer said action to the Helena Division of said court in the event the motion to dismiss on the ground the action was filed in the wrong division was denied, and a motion to require the joinder of Seaboard Surety Company as a party plaintiff in said cause. Thereafter the plaintiff filed a motion for summary judgment. Defendant's motions to dismiss were denied, its motion to transfer the cause to the Helena

Division of the court was granted; and defendant's motion to require the joinder of Seaboard Surety Company as a party plaintiff and plaintiff's motion for summary judgment are now before the Court for decision. Both parties have filed affidavits in support of their respective motions and in opposition to the motion of the other party.

From the complaint and affidavits it appears that the plaintiff McNeil Construction Company was engaged in a project in Yellowstone National Park and had in its employ as a night watchman one Lex Lamb, and that the said Lamb stole from the plaintiff 400 blank payroll checks and thereafter said Lamb forged the plaintiff's name to 29 of the checks, each of which he made payable to himself [54] in the amount of \$143.04, and each of which checks purported to cover the pay period ending either 9-26-56 or 9-25-56. Thereafter said Lamb cashed said forged checks at various places and they eventually reached the defendant bank and were paid by the defendant and charged against the account of plaintiff.

It further appears that the plaintiff McNeil Construction Company was insured against such loss by an indemnity bond issued by Seaboard Surety Company, and presented a "Statement of Claim" to said surety company under said bond for \$4148.-16, the amount of the forged checks, and received said amount from said surety company and executed an instrument entitled "Loan Receipt" which contained the following statement:

“Received from the Seaboard Surety Company (hereinafter referred to as “Company”) the sum of Four Thousand One Hundred Forty Eight Dollars and Sixteen Cents (\$4,148.16) Dollars as a loan, without interest, repayable only in the event and to the extent of any net recovery the undersigned may make from any person, persons, corporation or corporations, or other parties, causing or liable for the loss or damage described in the attached “Statement of Claim” incorporated herein, by reference or from any insurance, and as security for such repayment the undersigned hereby pledges to the said Company all of his, its or their claim or claims against said person, persons, corporation or corporations or other parties, or from any insurance carrier or carriers.”

The defendant contends that the money received by plaintiff is in fact “payment” under the provisions of its indemnity bond rather than a “loan” as it purports to be under the above loan receipt, and that therefore Seaboard Surety Company having paid the loss suffered by plaintiff is the real party in interest and should be brought into the suit as a party plaintiff. Plaintiff, on the other hand, maintains that the money received by the plaintiff from the surety company is in fact a loan and that the plaintiff therefore has not been paid for the loss occasioned by the forgeries, is the proper party plaintiff, and is entitled to summary judgment against the bank on the bank’s contract not to pay

out money from the account of plaintiff on any except a genuine signature. [55]

The first question to be decided is whether the money which was received by the plaintiff from the surety company constitutes a payment by the surety company of its obligation under the indemnity bond, or is merely a loan.

In the case of *Luckenbach vs. W. J. McCahan Sugar Refining Company*, 248 U. S. 139, the Supreme Court of the United States considered a somewhat similar transaction and upheld the validity of the so-called loan agreement. Since the decision in that case, loan receipt transactions have been considered by many courts and there is a definite conflict in the authorities as to whether as a matter of law such transactions constitute a loan or a payment of the surety's obligation under its bond.

Defendant contends that since the money was received by McNeil Construction Company and the loan receipt agreement was executed in California, California law should control, and that therefor under the case of *American Alliance Insurance Company vs. Capital National Bank*, 171 Pac. (2d) 449, the money was received by McNeil Construction Company from Seaboard Surety Company as a payment rather than as a loan. The so-called loan receipt transaction has not been considered by the Supreme Court of Montana and the plaintiff insists that because the transaction, which gave rise to the loan receipt agreement, occurred in the State of Montana, Montana law would govern, and this being

a diversity case that this Court should decide that if the question were presented to the Montana Supreme Court, it would uphold the loan receipt transaction as a loan.

In the view that the Court takes, it is unimportant whether California law or Montana law applies because the Court believes if the question were presented to the Montana Supreme Court it would follow the same reasoning that the California court adopted, and hold the transaction constituted "payment" rather than a "loan".

As previously noted, there is a conflict of authority on the question of whether or not moneys paid under loan receipt agreements constitute payments of the surety's obligation or merely a loan. Perhaps the majority of the cases uphold such payments as a loan, but they do so, however, in reliance on the *Luckenbach vs. [56] W. J. McCahan Sugar Refining Company* case, *supra*. The *Luckenbach* case is clearly distinguishable from the instant case. In the *Luckenbach* case the insurance company's liability was contingent upon the non-liability of the carrier, whereas Seaboard Surety Company's liability in the instant case is absolute under its bond. In other words, in the *Luckenbach* case, the insurance company was not obligated to pay until it was first established that the carrier was not liable for the damages. The insurance company advanced the amount of the loss as a loan in consideration of the owner of the cargo turning over to it the direction and control of the owner's suit to establish the carrier's liability. The

Court upheld the arrangement as a proper one to protect the insurance company's interest in the suit to establish the carrier's liability and to insure prompt payment to the insured of the loss.

In this case, however, a different situation prevails. As the Court said in the case of *Yezek vs. Delaware L. & W. Ry. Co.*, 176 Misc. 553, 28 N.Y.S. (2d) 35, which is quoted with approval in *American Alliance Insurance Company vs. Capital National Bank*, *supra*:

“The insurer's liability to the insured is absolute when the loss occurs. No shipper or other third party is involved. The insured is entitled to prompt payment without resort to a loan. The transaction is held to be a payment. * * * It was ‘payment without regard to its form’. The so-called loan was a fiction, a subterfuge unnecessary either to protect the insurer or to secure prompt payment to the insured.”

What the New York Court said in the quotation above applies equally in the case at bar.

The Luckenbach case also held that whether such a transaction constitutes a payment or a loan is a matter of intention of the parties. In this case, the only evidence of the parties' intention to engage in a loan transaction is the loan receipt. On the other hand, the evidence is that the money was paid by Seaboard to McNeil in the exact amount of McNeil's loss and was paid in response to a claim filed

by McNeil under the surety bond, the terms of which required Seaboard to pay McNeil the amount of the loss rather than make McNeil a loan. No interest was charged and the so-called loan was repayable only in the event and to the extent of any net recovery [57] which McNeil might make against third parties. Certainly McNeil does not consider itself a debtor to Seaboard as a result of the so-called loan, nor would Seaboard, in a suit by McNeil under the bond, hesitate to claim the so-called loan as a discharge of its obligation under the bond. Viewing the so-called loan transaction in the light of all of the evidence from which the true intention of the parties can be gleaned, the Court feels that the Montana Supreme Court would have little difficulty in holding that the money paid McNeil by Seaboard constituted "payment" of its obligation under the surety bond, and not a "loan," and this Court so holds.

Having been made whole by the payment of its loss by the surety company, under the provisions of Rule 17(a) of the Federal Rules of Civil Procedure and the case of *U. S. vs. Aetna Cas. & Sur. Co.*, 388 U. S. 366, McNeil Construction Company is not the proper plaintiff in this action, not being the real party in interest. It is equally clear under the doctrine of *U. S. vs. Aetna*, *supra*, that Seaboard Surety Company, having paid the loss is the real party in interest, if in the circumstances of the case, it is entitled to be subrogated to McNeil's claim against the bank.

The case of *Meyers vs. Bank of American Nat. Trust & Savings Assn.*, 77 Pac. (2d) 1087, contains a thorough discussion of the problem of when a surety, who had paid a loss under a fidelity bond, is entitled to the benefit of subrogation, and an exhaustive analysis of the cases dealing with that subject. That case points out that a surety's right to recover by way of subrogation from a third person does not stand on the same footing as its right to recover from its principal; as to the latter, that right is absolute, as to the former it is conditional. It further points out that the doctrine of subrogation has with almost unanimity been held not to apply in favor of a surety on a fidelity bond, except only as against persons who participated in the wrongful act of the wrongdoer. The ultimate holding in *Meyers vs. Bank of America* is that in a case such as the one at bar, the surety who has paid the loss has no right by way of subrogation to proceed against the bank unless there are facts from which it appears that in equity and good conscience the bank [58] rather than the surety should stand the loss. This holding is supported by the great weight of authority, and what is more important here, this being a diversity case, it is the law in Montana as announced in *American Bonding Co. vs. State Savings Bank*, 47 Mont. 332, 133 Pac. 367.

Therefore, Seaboard Surety Company's right to maintain an action against the defendant bank under the doctrine of subrogation depends upon the

existence of equities in its favor outweighing those in favor of the bank. The possibility that such equities may exist is suggested by evidence before the Court in the affidavits which might tend to show negligence on the bank's part in cashing and charging to McNeil's account 29 purported payroll checks payable to the same individual for the same payroll period. The Court is not now concerned with the questions of whether the bank's action in this respect amounted to negligence, and, if so, whether such negligence would constitute a sufficient equity in favor of Seaboard to entitle it to maintain an action against the bank under the doctrine of subrogation, however, because the complaint in this case contains no allegations of such negligence or of any other equities that might exist in Seaboard's favor. It is the action commenced by the complaint presently on file with which the Court is concerned, and from what has been said, it is apparent that Seaboard Surety Company is not the proper party plaintiff to that action, or otherwise stated, that the present complaint does not contain sufficient allegations to state a claim upon which Seaboard can recover. While Rules 19 and 21 of the Federal Rules of Civil Procedure authorize the Court to require the joinder of an indispensable party plaintiff in an action pending before it, they do not authorize the Court to require the joinder of a party in an action where the complaint does not state a claim upon which such party can possibly recover, and therefore defendant's motion to require the

joinder of Seaboard Surety Company as a party plaintiff is denied.

From what has been said above, it is clear that McNeil Construction Company's motion for summary judgment must also be [59] denied. As a matter of fact, summary judgment for the defendant should be ordered, because the plaintiff is not the proper party plaintiff to the claim stated in the complaint and cannot recover thereon in its own behalf. It has been suggested, however, that McNeil may still be entitled to maintain this action in its own name as a "trustee of an express trust" under the authority of *Dixey vs. Federal Compress & Warehouse Co.*, 132 Fed. (2d) 275 (by virtue of the following provisions found in the so-called loan receipt:

"And the undersigned (McNeil Construction Co.) covenants and agrees to co-operate fully with the said Company to permit it, at its own expense, to promptly present claim, and, if necessary, to likewise permit it at its own expense to commence, enter into and prosecute suit in the undersigned name against each person or persons, corporation or corporations, or other parties, through whose negligence or other fault the aforesaid loss was caused, or who may otherwise be responsible therefor, with all due diligence, in his, its or their own name."

Assuming, without deciding, that that is so, the present complaint is still insufficient. If McNeil is

bringing the action as a trustee of an express trust under the loan receipt, it is Seaboard's Surety Company's action that it is bringing, and as pointed out above under the *Meyers vs. Bank of America*, *supra*, and *American Bonding Co. vs. State Savings Bank*, *supra*, cases, a necessary part of Seaboard's action, if any, is allegations and proof of equities in favor of Seaboard outweighing those in favor of the defendant bank, and the complaint is devoid of such allegations.

Therefore, because from everything that is before the Court it appears that there may be equities in favor of Seaboard which would entitle it to recover, and because McNeil has suggested the possibility that it should be permitted to make the recovery on behalf of Seaboard as a trustee of an express trust, and in the interests of justice, McNeil Construction Company is granted 20 days within which to file an amended complaint, otherwise summary judgment will be ordered for defendant.

Done and dated this 4th day of December, 1957.

/s/ W. D. MURRAY,

United States District Judge.

[Endorsed]: Filed December 4, 1957.

Entered December 6, 1957. [60]

[Title of District Court and Cause.]

AMENDED COMPLAINT

Plaintiff above named for its amended complaint herein respectfully alleges as follows:

I.

That at all times herein mentioned the plaintiff, McNeil Construction Company, was and now is a corporation organized and existing under and by virtue of the laws of the State of California; that the defendant, Livingston State Bank, at all times herein mentioned was and now is a corporation organized and existing under and by virtue of the laws of the State of Montana; that the matter in controversy exceeds \$3,000.00 exclusive of interest and costs.

II.

That the defendant is a banking corporation organized and existing as aforesaid, and that it is engaged in the banking business and accepts deposits from individuals and from corporations and authorizes such individuals and corporations to draw checks on accounts maintained by such individuals and corporations in its aforesaid bank, which is located in the City of Livingston, Park County, Montana.

III.

That at all times herein mentioned the plaintiff, McNeil Construction Co., was engaged, among other things, in the general construction business, and during the summer and fall of [61] 1956 was

engaged in construction work in Yellowstone National Park, Wyoming, and that it maintained in the Livingston State Bank as aforesaid a bank account in excess of \$5,000.00 for the purpose, among other things, of drawing checks thereon to be issued to employees for work, labor and services performed by employees of said McNeil Construction Company.

IV.

That between September 13, 1956, and September 28, 1956, inclusive, the plaintiff employed one Lex Lamb as a night watchman on the project or work being done by it in Yellowstone National Park as aforesaid, and that unknown to the plaintiff and in September, 1956, said Lex Lamb stole from the plaintiff 400 blank payroll checks numbered 8401 to 8800, inclusive, from the offices maintained by the plaintiff, McNeil Construction Company, in Yellowstone National Park, Wyoming.

V.

That on or about September 26, 1956, said Lex Lamb forged the plaintiff's name to 29 of the checks stolen by him as aforesaid, each in the sum of \$143.04, each payable to Lexington Lamb or Lex Lamb, each for the same payroll period, and he cashed the same, and which checks were negligently paid by the defendant, Livingston State Bank, within a period of 15 days, in the total sum of \$4,148.16, from funds on deposit with the Livingston State Bank, and which deposit was made by the plaintiff, McNeil Construction Company, and that

said Livingston State Bank was advised of the theft of said 400 payroll checks and the forgery of 29 thereof by said Lex Lamb on or about October 26, 1956, which was within 30 days after the discovery by the plaintiff of the forgery of these checks and the receipt of the plaintiff of vouchers showing said payment.

VI.

That the defendant refuses to refund to plaintiff said [62] sum of \$4,148.16, which is due and owing to the plaintiff from the defendant.

VII.

That at all times herein mentioned plaintiff maintained a blanket position bond with Seaboard Surety Company, a corporation organized and existing under and by virtue of the laws of the State of New York, and that attached hereto as Exhibit A and made a part hereof as if set forth in full is a photostatic copy of said blanket position bond; that after defendant and its indemnity company declined to reimburse McNeil Construction Company for the loss hereinabove referred to, plaintiff applied to Seaboard Surety Company for reimbursement of said \$4,148.16, and that thereupon Seaboard Surety Company paid to the plaintiff said sum under a loan receipt agreement, a copy of which is attached hereto as Exhibit B and made a part hereof as if set forth in full, and that this action is brought by plaintiff not only on its own behalf, but as trustee of an express trust under the provisions of Exhibit B.

Wherefore, plaintiff demands judgment against the defendant in the total sum of \$4,148.16 with interest thereon at the rate of 6 per cent from the 1st day of November, 1956, together with the costs and disbursements of this action.

BROWN, SANDE, SYMMES &
FORBES,

By /s/ WEYMOUTH D. SYMMES,
Attorneys for Plaintiff.

[Endorsed]: Filed December 9, 1957. [63]

[Title of District Court and Cause.]

MOTION AND NOTICE

Comes now the defendant and moves the Court as follows:

1. To dismiss the action because the Amended Complaint fails to state a claim against the defendant upon which relief can be granted.

2. In the event said action is not dismissed, to require the joinder of Seaboard Surety Company as a party plaintiff in said cause, and to summons said Seaboard Surety Company to appear in said action, pursuant to the provisions of Rules 19 and 21, Federal Rules of Civil Procedure, on the ground that the Amended Complaint shows on its face that said Seaboard Surety Company is the real party in interest and a necessary party plaintiff in said cause.

3. In the event said action is not dismissed, to strike from the Amended Complaint on file herein the words "and its indemnity company," appearing in paragraph VII thereof, on the ground that such matter is an improper allegation, evidence of which would be incompetent, and on the further ground that such matter is redundant and immaterial.

Dated this 18th day of December, 1957.

LUXAN & SCRIBNER,

/s/ A. W. SCRIBNER,

Attorneys for Defendant.

[Endorsed]: Filed December 19, 1957. [69]

In the United States District Court for the
District of Montana, Helena Division

No. 758

McNEIL CONSTRUCTION COMPANY, a Corporation,

Plaintiff,

vs.

THE LIVINGSTON STATE BANK, a Corporation,

Defendant.

ORDER

Pursuant to permission granted in the Court's order of December 4, 1957, in this cause, plaintiff has filed an amended complaint in which it attempts

to state a cause of action by it as trustee of an express trust in favor of Seaboard Surety Company. Defendant has filed a motion to dismiss the amended complaint for failure to state a claim, and in the alternative a motion to require the joinder of Seaboard Surety Company as a party plaintiff, and an alternative motion to strike certain allegations from the amended complaint. Said motions were set for hearing, argument was had and briefs in support of and in opposition to said motions have been filed by the parties and said arguments and briefs have been considered by the Court.

The Court is of the opinion that the amended complaint does not state a claim upon which relief can be granted to McNeil Construction Company as trustee of an express trust for Seaboard Surety Company.

The Court is further of the opinion that the provision of the loan receipt agreement, which McNeil Construction Company contends makes it a trustee of an express trust for Seaboard Surety Company, does not have that effect. Therefore, not only does the amended complaint fail to state a claim upon which relief can be granted to McNeil Construction Company upon the theory of an express trust, but it is also impossible for McNeil Construction [71] Company to state such a claim because the loan receipt agreement does not constitute McNeil an express trustee for Seaboard.

For the foregoing reasons, It Is Ordered and this does order that the motion to dismiss the amended

complaint be granted, and said amended complaint is hereby ordered dismissed.

It Is Further Ordered that the Clerk of this court forthwith notify the attorneys of record for the respective parties of the making of this order.

Done and dated this 10th day of April, 1958.

/s/ W. D. MURRAY,

United States District Judge.

[Endorsed]: Filed April 10, 1953.

Entered April 11, 1958. [72]

[Title of District Court and Cause.]

NOTICE OF APPEAL

To: Defendant, The Livingston State Bank, a Corporation, and to Luxan & Scribner, Attorneys for Said Defendant, P. O. Box 1144, Helena, Montana:

Sirs:

Notice Is Hereby Given, that plaintiff, McNeil Construction Company, a corporation, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Order of the Honorable W. D. Murray, United States District Judge for the District of Montana, dated April 10, 1958, dismissing the Amended Complaint herein and which finally determined this action, and which was en-

tered in this action on April 10, 1958, and from each and every interlocutory order reviewable by the Court of Appeals which was entered prior to the entry of the final Order hereinabove more specifically referred to.

Dated this 7th day of May, 1958.

BROWN, SANDE, SYMMES &
FORBES,

/s/ WEYMOUTH D. SYMMES,
Attorneys for the Plaintiff.

[Endorsed]: Filed May 9, 1958. [73]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,
District of Montana—ss.

I, Dean O. Wood, Clerk of the United States District Court for the District of Montana, do hereby certify that the annexed papers are the originals filed in Case No. 758, McNeil Construction Company, a corporation, Plaintiff, vs. The Livingston State Bank, a corporation, Defendant, as designated by the parties as the record on appeal in said cause, except Plaintiff's Exhibit No. 1, consisting of Twenty-eight (28) cancelled checks which are here transmitted separately.

I further certify that on May 21, 1958, I mailed a true copy of plaintiff's Notice of Appeal in said cause to each of the attorneys of record for the defendants at their respective residences, and that the fee of Five Dollars (\$5.00) for filing Notice of Appeal was paid on the date of the filing of said Notice of Appeal.

Witness my hand and the seal of said Court at Helena, Montana, this 5th day of June, 1958.

[Seal] DEAN O. WOOD,
Clerk as Aforesaid.

By /s/ ETHEL FLEMING,
Deputy Clerk. [80]

[Endorsed]: No. 16050. United States Court of Appeals for the Ninth Circuit. McNeil Construction Company, a Corporation, Appellant, vs. The Livingston State Bank, a Corporation, Appellee. Transcript of Record. Appeal From the United States District Court for the District of Montana.

Filed: June 9, 1958.

Docketed: June 17, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 16050

McNEIL CONSTRUCTION COMPANY, a Corporation,

Appellant,

vs.

THE LIVINGSTON STATE BANK, a Corporation,

Appellee.

APPELLANT'S STATEMENTS OF POINTS
ON WHICH IT INTENDS TO RELY

Pursuant to Rule 17 (6) of the Rules of Practice of the United States Court of Appeals for the Ninth Circuit, the plaintiff and appellant in the above-entitled action specifies its points on which it intends to rely on as follows:

1. The District Court erred in denying plaintiff and appellant's Motion for Summary Judgment.
2. The District Court erred in dismissing the original Complaint filed herein by the plaintiff and appellant with leave to the plaintiff to amend.
3. The District Court erred in dismissing the Amended Complaint herein on motion of the defendant and appellee.

Dated this 16th day of June, 1958.

BROWN, SANDE, SYMMES &
FORBES,

By /s/ WEYMOUTH D. SYMMES,
Attorneys for Appellant.

Affidavit of mailing attached.

[Endorsed]: Filed June 17, 1958.

**United States
Court of Appeals**

For the Ninth Circuit

McNEIL CONSTRUCTION COMPANY,
a corporation,

Appellant,

v.

THE LIVINGSTON STATE BANK,
a corporation,

Appellee.

Appellee's Brief

Appeal from the United States District Court for
the District of Montana

LUXAN & SCRIBNER
322 Fuller Avenue
Helena, Montana

A. W. SCRIBNER, of Counsel
Attorneys for Appellee

FILED

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United States Court of Appeals

For the Ninth Circuit

McNEIL CONSTRUCTION COMPANY,
a corporation,

Appellant,

v.

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Appellee's Brief

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A. W. SCRIBNER, of Counsel
Attorneys for Appellee

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United States Court of Appeals

For the Ninth Circuit

McNEIL CONSTRUCTION COMPANY,
a corporation,

Appellant,

v.

THE LIVINGSTON STATE BANK,
a corporation,

Appellee.

Appellee's Brief

Appeal from the United States District Court for
the District of Montana

Plaintiff has appealed from an order of the district court dismissing its amended complaint. It seeks by this appeal not only to review the action of the district court in dismissing the amended complaint, but also to review the orders of the court which were entered upon the issues presented under the original complaint, and which imposed conditions voluntarily ac-

cepted by the plaintiff. We contend that the prior orders are not properly before this Court for review, and to demonstrate that contention we wish to recount briefly the developments leading up to the dismissal of the amended complaint.

On May 1, 1957, appellant filed its complaint, seeking to recover from the appellee for damages it claimed to have sustained by reason of the alleged payment of forged payroll checks drawn on plaintiff's account. (R. 3-6).

On May 28, 1957, defendant filed motions to dismiss and to add the Seaboard Surety Company as a party plaintiff. (R. 6-10).

On May 29, 1957, plaintiff filed requests for admissions, which were responded to in due course by the defendant. (R. 10-24).

On August 19, 1957, plaintiff filed its motion for summary judgment and supporting affidavits. A counter-affidavit was later filed by the defendant, and thereafter supplementary affidavits were filed by the plaintiff. (R. 24-72).

On December 4, 1957, the Honorable W. D. Murray entered an order (a) denying defendant's motion to add Seaboard Surety as a party plaintiff, (b) denying plaintiff's motion for summary judgment, and (c) granting the plaintiff twenty days within which to file an amended complaint, otherwise summary judgment to be entered in favor of the defendant. The reasons for Judge Murray's decision were fully expressed by him in the order, which appears in the record at pages 74 to 84, inclusive. The court held that (a) Mc-

Neil Construction Company was not the proper party plaintiff because its loss had been paid in full by Seaboard Surety Company (R. 76-80); and (b) the complaint did not state a claim upon which either McNeil or Seaboard could recover, and for this reason summary judgment should be entered in favor of the defendant. (R. 80-84). However, in the interests of justice (R. 84), the court granted McNeil an opportunity to amend its complaint, stating that it was perhaps possible for plaintiff to state a claim, based on the doctrine of equitable subrogation, and on the theory that it was the trustee of an express trust.

On December 9, 1957, and within the twenty day period allowed by the court, the plaintiff filed its amended complaint, thus avoiding the entry of summary judgment (R. 85-88).

On December 19, 1957, defendant filed its motion to dismiss or, in the alternative, to require the joinder of Seaboard Surety Company as party plaintiff. (R. 88, 89).

On April 11, 1958, Judge Murray entered an order dismissing plaintiff's amended complaint, holding (a) that the amended complaint did not state a claim upon which relief could be granted, and (b) that the amended complaint revealed that plaintiff was not the trustee of an express trust. (R. 89-91).

On May 9, 1958, plaintiff filed its notice of appeal, stating that it was appealing from the last mentioned order, "and from each and every interlocutory order reviewable by the Court of Appeals which was entered

prior to the entry of the final Order hereinabove more specifically referred to.”

I. APPELLANT'S SPECIFICATIONS OF ERROR NUMBERED 1 AND 3 ARE NOT PROPERLY BEFORE THIS COURT FOR REVIEW.

Appellant's specifications of error are set forth in its brief at page 15. They are:

“1. The Court erred in dismissing the original Complaint.

2. The Court erred in dismissing the Amended Complaint.

3. The Court erred in denying plaintiff's Motion for Summary Judgment.”

It will be noted that specifications numbered 1 and 3 are in respect of the order of court dated December 4, 1957, granting plaintiff twenty days to file an amended complaint as an alternative to the entry of summary judgment in favor of the defendant. The order gave plaintiff a clear choice as to the course it could pursue. Plaintiff could have obtained a review of the decisions rendered in that order by appealing from a judgment entered thereon after lapse of the twenty day period. Instead plaintiff chose to accept the conditions imposed by that order, and filed an amended complaint within the prescribed period. This constituted a positive election to go forward under the rules laid down by the court, and an absolute waiver of the right to a review of the order.

The general rule is stated in 4 C. J. S., *Appeal and Error*, Section 212, at page 617, as follows:

“A party who voluntarily acquiesces in, ratifies, or recognizes the validity of, a judgment,

order, or decree against him, or otherwise takes a position which is inconsistent with the right to appeal therefrom, thereby impliedly waives, or is estopped to assert, his right to have such judgment, order, or decree reviewed by an appellate court; and this rule has been held to apply where the acquiescence or ratification was either partial or in toto. The 'acquiescence' which prohibits an appeal is an acquiescence in a judgment, decree, or order, which commands something to be done or given, and consequently, acquiescence occurs when the thing is done or given. In order to be a bar of the right of appeal on the ground of acquiescence, the judgment or decree must have been rendered and entered, and the acts relied on, as a waiver or estoppel on such ground, must be such as to clearly and unmistakably show an inconsistent course of conduct or an unconditional, voluntary, and absolute acquiescence, with the intent, as has been held, to ratify or confirm the judgment as rendered, and to acquiesce and abandon the right of appeal."

A more specific application of the principle may be found in the same section, at page 621:

"As a general rule, if a trial court imposes terms as the condition on which a continuance or an amendment will be allowed, or a default judgment will be opened, or on which any other order will be granted or any other thing done or not done, and the party on whom the terms are imposed accepts them, he will be deemed to have acquiesced in the ruling and cannot afterward question its validity in the appellate court."

In re Smith (9 Cir. 1934), 71 F. 2d 378, involved an appeal from an order of the district court adjudicating the rights of a bankrupt in the estate of a deceased person. The bankrupt also appealed from an order requiring her to execute and deliver to the trustee a stip-

ulation of dismissal of another action pending in another court. The court dismissed the last mentioned appeal for the following reasons, stated in its opinion at page 381:

“Appellee contends that this appeal should be dismissed because no substantial argument has been made to show why the order was erroneous and because the appeal had become moot by reason of compliance with the order complained of. Compliance, as shown by an exhibit, is not denied. This appeal must therefore be dismissed. *American Book Co. v. Kansas* (1904) 193 U.S. 49, 24 S. Ct. 394, 48 L. Ed. 613.”

Bennell Realty Co. vs. E. G. Shinner & Co. (7 Cir. 1937), 87 F. 2d 824, was an appeal from a decree based on an appraiser's award. A prior appraisal had been set aside by the court, by interlocutory decree granting to the parties the opportunity of designating new appraisers and obtaining a re-appraisement. Appellant claimed that the court erred in setting aside the first appraisal. It was held that the appeal was moot because appellant had voluntarily accepted the provisions of the interlocutory decree by designating new appraisers and proceeding with the re-appraisal. The court said, page 826:

“We are convinced that appellant by proceeding under the voluntary provisions of the third paragraph of the interlocutory decree precluded itself from relying upon its objections and exceptions to the court's ruling in setting aside the first appraisal and permitting another. There was nothing compulsory in the third paragraph of the interlocutory decree. It amounted to nothing more than a permissive gesture of the court, looking to an amicable settlement of the parties' differences. They both accepted the benefits of that suggestion,

among which was the chance of each party getting a re-appraisement more favorable to itself, and also the avoidance of delay and expense in further pursuing the mandatory course which the court had ordered in case the provisions of the voluntary program should not be followed. When they voluntarily accepted this chance, they took it with its burdens as well as its benefits, and the procedure was utterly inconsistent with appellant's intention to further pursue the court's alleged error in setting aside the first appraisement."

This principle was adhered to by the Montana supreme court in *Harrington vs. Butte, Anaconda & Pacific R. Co.* (1909), 39 Mont. 22, 101 Pac. 149. Mr. Chief Justice Brantly wrote the opinion of the court, portions of which are hereinafter quoted:

"The language of the plaintiff's acceptance of the condition is: 'And this plaintiff * * * does hereby remit all damages in excess of,' etc. The reservation, expressed in the form of a condition, is in fact no condition, but the reservation of an exception expressive of an intention to question the power of the court to make the order at all. If he had this right to question the court's power, he had it without the reservation; but he could not comply with the condition imposed and still say the court had no power to impose it. He could not say, 'I accept the advantage offered me of avoiding a new trial, but I will proceed to test the question whether the court had the power to grant me this advantage; and if I find that the power does not exist, I will be the gainer to the amount of \$3,500, while my adversary, if he chooses to submit to the order, becomes the loser to this amount.' The only course open to him was to waive all irregularity in the proceedings on the motion and comply with the order, or to refuse to comply at all. He would then have been in a position to question the regularity of the proceedings on the mo-

tion anterior to the order. As it is, he cannot be heard to say that the order in his favor made so by his own act of acceptance of its conditions, is not binding upon him, or that he is aggrieved by it. Taking either view of the case, the plaintiff's contentions are without merit. If the order did not by his act become absolute, the appeal is premature, and defendant's motion to dismiss it must be sustained. If it did become absolute, the order is in his favor, made so virtually by his consent, and hence he cannot say that he has been aggrieved by it. The situation is anomalous, to say the least, and not without difficulty; but we are not disposed to adopt a view which recognizes a right in litigants to juggle with a court, as plaintiff has shown a disposition to do in this case. We hold that by filing his acceptance, couched in the terms it is, the plaintiff waived any irregularity in the proceedings on the motion, and that, having thereby avoided another trial, he has no grievance which he may submit to this court. The appeal is therefore dismissed on this ground."

The comments made in the foregoing cases are equally applicable to this case. Appellant complains, on page 13 of its brief, that the court's action put the plaintiff in a precarious position, and that plaintiff could not risk an appeal from the former order because it would have become a judgment on the merits if this Court should affirm. But this is no reason to permit the plaintiff to accept the fruits of the former order without being bound by its conditions. As was stated by the United States Supreme Court in *American Book Co. vs. Kansas* (1904), 193 U.S. 49 (cited by this Court in *In Re Smith* (9 Cir. 1934), 71 F. 2d 378, *supra*):

"The judgment has been complied with. It makes no difference that plaintiff in error 'felt coerced' into compliance. A judgment usually has

a coercive effect, and necessarily presents to the party against whom it is rendered the consideration whether it is better to comply or continue the litigation. After compliance there is nothing to litigate.”

II. APPELLANT IS NOT THE REAL PARTY IN INTEREST.

(a) This Court Should Defer to the Trial Judge’s Interpretation of Montana Law.

The district court, by its first order dated December 4, 1957, (R. 74), held that the plaintiff, McNeil Construction Company, was not the real party in interest because its loss had been paid in full by the Seaboard Surety Company. (In addition the court held that the complaint failed to state a claim upon which either McNeil or Seaboard could recover. This point will be discussed at another portion of this brief.) The court gave plaintiff an opportunity to amend its complaint, stating that it was perhaps possible for the plaintiff to maintain this action upon the theory that it was the trustee of an express trust. By its second order, dated April 10, 1958, (R. 89), the court decided that the complaint revealed that McNeil was not the trustee of an express trust, and, in effect, held that McNeil was not, under any conceivable theory, the real party in interest.

Plaintiff relies on the document entitled “Loan Receipt”, attached to its amended complaint, marked “Exhibit B”, and appearing in the record at page 37. It maintains that McNeil has simply received a “loan” from the surety company and that the document referred to creates an express trust in favor of the Sea-

board Surety Company. The district court rejected both contentions.

The reasons for the court's decision that plaintiff was not the real party in interest are stated in its first order, appearing in the record at page 74. We quote certain portions thereof below:

"Defendant contends that since the money was received by McNeil Construction Company and the loan receipt agreement was executed in California, California law should control, and that therefore under the case of *American Alliance Insurance Company vs. Capital National Bank*, 171 Pac. (2d) 449, the money was received by McNeil Construction Company from Seaboard Surety Company as a payment rather than as a loan. The so-called loan receipt transaction has not been considered by the Supreme Court of Montana and the plaintiff insists that because the transaction, which gave rise to the loan receipt agreement, occurred in the State of Montana, Montana law would govern, and this being a diversity case that this Court should decide that if the question were presented to the Montana Supreme Court, it would uphold the loan receipt transaction as a loan.

In the view that the Court takes, it is unimportant whether California law or Montana law applies because the Court believes if the question were presented to the Montana Supreme Court it would follow the same reasoning that the California court adopted, and hold the transaction constituted 'payment' rather than a 'loan'."

Then, after considering the case of *Luckenbach vs. W. J. McCahan Sugar Refining Company* (1918), 248 U.S. 139, and the case of *Yezek vs. Delaware L. & W. R. Co.* (1941), 176 Misc. 553, 28 N.Y.S. 2d 35, the court went on to state:

"The Luckenbach case also held that whether

such a transaction constitutes a payment or a loan is a matter of intention of the parties. In this case, the only evidence of the parties' intention to engage in a loan transaction is the loan receipt. On the other hand, the evidence is that the money was paid by Seaboard to McNeil in the exact amount of McNeil's loss and was paid in response to a claim filed by McNeil under the surety bond, the terms of which required Seaboard to pay McNeil the amount of the loss rather than make McNeil a loan. No interest was charged and the so-called loan was repayable only in the event and to the extent of any net recovery which McNeil might make against third parties. Certainly McNeil does not consider itself a debtor to Seaboard as a result of the so-called loan, nor would Seaboard, in a suit by McNeil under the bond, hesitate to claim the so-called loan as a discharge of its obligation under the bond. Viewing the so-called loan transaction in the light of all of the evidence from which the true intention of the parties can be gleaned, the Court feels that the Montana Supreme Court would have little difficulty in holding that the money paid McNeil by Seaboard constituted 'payment' of its obligation under the surety bond, and not a 'loan', and this Court so holds.

Having been made whole by the payment of its loss by the surety company, under the provisions of Rule 17(a) of the Federal Rules of Civil Procedure and the case of *U. S. vs. Aetna Cas. & Sur. Co.*, 388 U.S. 366, McNeil Construction Company is not the proper plaintiff in this action, not being the real party in interest. It is equally clear under the doctrine of *U. S. vs. Aetna*, supra, that Seaboard Surety Company, having paid the loss is the real party in interest, if in the circumstances of the case, it is entitled to be subrogated to McNeil's claim against the bank."

From the above, it can be seen that the district court made a determination that the Montana Supreme

Court, if the question were presented to it, would hold that the transaction involved in this case constituted "payment" rather than a "loan". In doing so, it recognized the rule, which is conceded by both parties, that the effect and validity of the loan receipt transaction upon the parties thereto is a question of substantive law. *Rosenfeld vs. Continental Building Operating Company* (D.C. Mo. 1955), 135 F. Supp. 465. The appellant asks this Court to reverse the decision of the district court, based upon its interpretation of the substantive law of Montana. Counsel would have this Court hold that Judge Murray erred in deciding that the Montana supreme court would view this transaction as constituting "payment" rather than a "loan". He wants the Court to substitute its judgment for the considered judgment of the district court on a matter which is concededly an open question in Montana, and upon which there is diversity of opinion elsewhere.

This Court has recently held that it will defer to the trial judge's interpretation of state law in such circumstances and will not reject any such interpretation unless it is manifestly contrary to the decisions of the state court. In *People of the State of California vs. United States* (9 Cir. 1956), 235 F. 2d 647, the Court accepted the views of the trial judge, sitting in California, on matters of California water law, stating as follows in the opinion at page 653:

"Here the United States 'claims only such rights to the use of water as it acquired when it purchased Rancho Santa Margarita, together with any rights which it may have gained by prescription or use or both since' that time. Inasmuch as

the rights at the date of acquisition depend upon the law of the state, this Court defers to the interpretation of the able trial judge, himself a lawyer of the state of long standing, acquainted with the imponderables and implications inherent in the pronouncement of the courts of the state. This Court will not reject any such interpretation unless convinced that it be manifestly contrary to the holdings of the local tribunals."

And in *Bower vs. Bower* (9 Cir. 1958), 255 F. 2d 618, this Court, in a per curiam opinion and for the same reason, declined to overrule a decision of District Judge Jameson as to how the Montana supreme court would decide the validity of a property settlement agreement.

A similar practice has long been observed by the United States Supreme Court. For example, in *Hudleston vs. Dwyer* (1944), 322 U. S. 232, it was stated in a per curiam opinion at page 237:

"The decision of the highest court of a state on matters of state law are in general conclusive upon us, and ordinarily we accept and therefore do not review, save in exceptional cases, the considered determination of questions of state law by the intermediate federal appellate courts, cf. *Ruhlin v. New York Life Ins., Co.*, supra. When we are called upon to decide them, the expression of the views of the judges of those courts, who are familiar with the intricacies and trends of local law and practice, if not indispensable, is at least a highly desirable and important aid to our determination of state law questions. This Court will not ordinarily decide them without that aid where they may conveniently first be decided by the court whose judgment we are called upon to review. See, e. g., *Ruhlin v. New York Life Ins. Co.*, supra; *Rosenthal v. New York Life Ins. Co.*, 304 U.S. 264, 264, 58 S. Ct. 874, 875, 82 L. Ed.

1330; *West v. A. T. & T. Co.*, 311 U. S. 223, 241, 61 S. Ct. 179, 185, 85 L. Ed. 139, 132 A.L.R. 956; *Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487, 497, 61 S. Ct. 1020, 1022, 85 L. Ed. 1477; *Meredith v. Winter Haven*, *supra*."

The courts of appeals in other circuits have applied similar rules in reviewing the decisions of district courts as to interpretations of local law. In *Kimble vs. Willey* (8 Cir. 1953), 204 F. 2d 238, the following comments were made (opinion, page 243) :

"We conclude that the decision of the District Court is supported by available authority. But even in the absence of such authority, this court will not in this case substitute its judgment for that of the District Court.

"This Court has repeatedly ruled that it will accept the considered views of a District Judge as to doubtful questions of local law. Many of the cases in this Court and the Supreme Court which support that rule will be found in the case of *Buder v. Becker*, 8 Cir., 185 F.2d 311, 315-316. In *Western Casualty & Surety Co. v. Coleman*, 8 Cir., 186 F.2d 40, 43, we said: 'The burden of demonstrating error is upon the Casualty Company. In a case controlled by local law, that burden is a peculiarly heavy one. This Court is not an appellate court of the State of Missouri and establishes no rules of law for that State. We have repeatedly said that, in reviewing doubtful questions of local law, we would not adopt views contrary to those of the trial judge unless convinced of error, and that all that this Court reasonably can be expected to do in such cases is to see that the determination of the trial court is not induced by a clear misconception or misapplication of the local law. *Russell v. Turner*, 8 Cir., 148 F.2d 562, 564; *Buder v. Becker*, 8 Cir., 185 F.2d 311, 315, and cases cited. If a federal district judge has reached a permissible conclusion upon a question

of local law, we will not reverse, even though we may think the law should be otherwise.' *National Bellas Hess, Inc. v. Kalis*, 8 Cir., 191 F.2d 739, 741."

In this case the trial judge, a distinguished member of the bar of the state of Montana, made an interpretation of the substantive law of Montana when he held that the Montana supreme court would view this "loan receipt" transaction as full payment of the loss. His reasons for so concluding are fully set forth in the order dated December 4th, and were based upon an absence of authoritative decisions in Montana and a conflict of authority elsewhere. The appellant has failed to demonstrate that this interpretation of the local law is "manifestly contrary" to the Montana decisions, and therefore, under the rule adopted by this Court, that decision should stand.

(b) The District Court Was Correct in its Determination that Plaintiff Was Not the Real Party in Interest.

Even if the decision of Judge Murray on the question under consideration were to be subject to the independent review of this Court, we submit that it was eminently correct and should be upheld.

The cases uniformly hold that where plaintiff's loss has been paid in full by insurance, the insurer is the real party in interest within the meaning of Rule 17 (a), Federal Rules of Civil Procedure. *United States vs. Aetna Casualty & Surety Co.* (1949), 338 U.S. 366, was a case involving partial payment of a plaintiff's claim, and the Court, speaking through Mr. Chief Justice Vinson, interpreted Rule 17(a) as follows (opinion, page 380):

“Rule 17(a) of the Federal Rules of Civil Procedure, 28 U.S.C.A., which were specifically made applicable to Tort Claims litigation, provides that ‘Every action shall be prosecuted in the name of the real party in interest,’ and of course an insurer-subrogee, who has substantive equitable rights, qualifies as such. If the subrogee has paid an entire loss suffered by the insured, it is the only real party in interest and must sue in its own name. 3 Moore, Federal Practice (2d Ed.) p. 1339. If it has paid only part of the loss, both the insured and insurer (and other insurers, if any, who have also paid portions of the loss) have substantive rights against the tortfeasor which qualify them as real parties in interest.”

The *Aetna Casualty Company* case is binding upon all federal courts in respect to this question, since Rule 17(a) involves a matter of procedure. Consequently, if the fact of payment were conceded by plaintiff in this case, the defendant would prevail as a matter of law. However, the plaintiff relied upon the fact that the transaction between Seaboard Surety Company and the plaintiff was in the form of a Loan Receipt. This presented a question which has been considered often by both federal and state courts. This has resulted in a conflict in the decisions, some courts holding that such transactions do not constitute payment, and others reaching the opposite conclusion.

Loan receipts were developed as a means of preventing carriers and bailees from inequitably shifting the burden of loss that was rightfully theirs on to the shoulders of the shipper's or bailor's insurance carrier. They have been used by insurance companies in such situations for many decades, and from time to time in past years the courts have had occasion to pass upon

the legal effect of such transactions. In most cases the transactions, used for the purpose referred to, were held to be valid arrangements and were generally upheld as "loans". The Supreme Court of the United States passed upon this type of an arrangement in the case of *Luckenbach vs. W. J. McCahan Sugar Refining Co.* (1918), 248 U.S. 139. The case involved the question of a carrier's liability to a cargo owner for damages resulting from the unseaworthiness of the vessel. The carrier claimed that it was not liable because the cargo owner had already been compensated by insurance and that it was entitled to the benefit of the insurance under the clause in the bill of lading which provided that in case of a loss for which the carrier shall be liable it should have "the full benefit of any insurance that may have been effected upon or on account of such goods". The Court held that the insurer had not made a payment but had advanced a loan to the cargo owner and that the loan receipt was valid evidence of such transaction. Justice Brandeis stated in the opinion:

"Whether the transfer of money or other thing shall operate as a payment, is ordinarily a matter which is determined by the intention of the parties to the transaction. Compare *The Kimball*, 3 Wall. 37, 44, 18 L.Ed. 50. The insurer could not have been obliged to pay until the condition of their liability—i.e. non-liability of the carrier—had been established. The shipper could not have been obliged to surrender to the insurers the conduct of the litigation against the carrier, until the insurers had paid. In consideration of securing then the right to conduct the litigation, the insurers made the advances. It is creditable to the

ingenuity of business men that an arrangement should have been devised which is consonant both with the needs of commerce and the demands of justice.”

Since the *Luckenbach* decision, the loan receipt has become a popular device, and there now exists a conflict in the decisions as to whether, under ordinary circumstances, such transactions constitute payment. Many courts, perhaps the majority, have cited the *Luckenbach* case as authority for the proposition that a loan receipt transaction does not constitute payment and that, accordingly, the insured remains the real party in interest.¹ However, as the district court pointed out in its opinion (R. 78) the *Luckenbach* case is clearly distinguishable from this case. In the *Luckenbach* case the insurance company's liability was contingent upon the non-liability of the carrier, whereas in this case the surety company's liability is absolute. As stated by the district court, “in the Luckenbach case, the insurance company was not obligated to pay until it was first established that the carrier was not liable for the damages. The insurance company advanced the amount of the loss as a loan in consideration of the owner of the cargo turning over to it the direction and control of the owner's suit to establish the carrier's liability. The court upheld the arrangement as a proper one to protect the insurance company's interest in the suit, to

¹ See for example: *The Plow City* (3 Cir. 1941), 122 F.2d 816; *Merriman vs. Cities Service Co.* (D.C.S.D. Mo. 1951), 11 F.R.D. 165; *Williams vs. Union Pacific Railroad Co.* (D.C. Neb. 1950), 94 F. Supp. 174; *Blair vs. Espeland* (Minn. 1950), 43 N.W. 2d 274; *Shiman Bros. & Co. vs. Nebraska National Hotel Co.* (1943), 143 Neb. 404, 9 N.W. 2d 807; *State Farm Mutual Auto Insurance Co. vs. Hall* (1942), 292 Ky. 22, 165 S. W. 2d 838; and *Phillips vs. Clifton Manufacturing Co.* (1944), 204 S.C. 496, 30 S.E. 2d 146.

establish the carrier's liability and to insure prompt payment to the insured of the loss".

The district court then went on to quote from *Yezek vs. Delaware L. & W. R. Co.* (1941), 176 Misc. 553, 28 N.Y.S. 2d 35, *supra*, to illustrate the distinction:

"The insurer's liability to the insured is absolute when the loss occurs. No shipper or other third party is involved. The insured is entitled to prompt payment without resort to a loan. The transaction is held to be a payment. * * * It was 'payment without regard to its form'. The so-called loan was a fiction, a subterfuge unnecessary either to protect the insurer or to secure prompt payment to the insured."

In *Rosenfeld vs. Continental Building Operating Company*, (D.C. Mo. 1955), 135 F. Supp. 465, the district court had before it a similar problem of determining the substantive state law on this question. We quote from the opinion:

"Rule 17(a) requires simply that 'Every action shall be prosecuted in the name of the real party in interest'. That means that the one who seeks relief upon a claim must, legally, or equitably, own the claim under the substantive law of the state, *United States v. Allbaugh*, D.C. Neb., 83 F. Supp. 109; *Carlson v. Glenn L. Martin Co.*, D. C. Ohio, 103 F. Supp. 153; *Capo v. C-O Two Fire Equipment Co.*, D.C.N.J., 93 F. Supp. 4; *DuRoure v. Alvord*, D.C. N.Y., 120 F. Supp. 166, and *Koepp v. Northwest Freight Lines*, D.C. Minn., 10 F.R.D. 524, and, therefore, in determining who is the real party in interest under Rule 17(a) the Court must first ascertain who has the substantive right of action under the controlling substantive state law, *American Fidelity & Casualty Co. v. All-American Bus Lines*, 10 Cir., 179 F. 2d 7, 10; *McWhirter v. Otis Elevator Co.*, D.C.S.C., 40 F.Supp. 11, and

Montgomery Ward & Co. v. Callahan, 10 Cir., 127 F. 2d 32, 36.”

The court then proceeded to apply the substantive law of New York, the state where the loan receipt had been executed and the insured had received payment. Its decision was based upon the New York law to the effect that loan receipt transactions were not valid unless authorized in the particular insurance policy, and the court held that the loan receipt transaction constituted payment. In that respect the following comment was made:

“I am, therefore, of the opinion that the substantive law of New York upon the question, as determined by the last decisions of its highest court above cited, is that if the policy contains provisions authorizing the insurer to settle its liabilities with the insured by a loan, the loan is not payment, but otherwise it is payment. Here, there is no provision in the policy authorizing the insurer to settle its liabilities by a loan, and, therefore, under the controlling law of New York, the ‘loan’ was payment, and, under the holding of the Supreme Court in *United States v. Aetna Casualty & Surety Co.*, 338 U.S. 366, 70 S.Ct. 207, 94 L.Ed. 171, the insurer is the real party in interest and must prosecute the suit in its own name.”

We had contended before the district court that, since the loan receipt in question here was executed in California, California law applied and that the case was controlled by *American Alliance Insurance Co. vs. Capital National Bank* (1946), 75 Cal. App. 2d 787, 171 P. 2d 449.² The plaintiff had contended that Montana law was applicable. The court obviated the ne-

² For decisions of other state courts to the same effect, see: *Cleveland Paint & Color Co. vs. Bower Mfg. Co.* (1951), 155 Ohio St. 17, 97 N.E. 2d 545; and *McKenzie vs. North River Insurance Co.* (1951), 257 Ala. 265, 58 S.2d 581.

cessity of deciding this point by concluding that the Montana supreme court would view the transaction as "payment" rather than as a "loan".

(c) Plaintiff May Not Maintain the Action as Trustee of an Express Trust

In its first order, the district court left open the question whether the plaintiff could maintain an action in its own name, as trustee of an express trust, on behalf of Seaboard Surety Company. The theory adopted by the plaintiff in its amended complaint, and rejected by the district court in its second order, is that the loan receipt constituted an express trust, entitling plaintiff to sue in its own name under the provisions of Rule 17(a), Federal Rules of Civil Procedure.

The rule announced in the case of *United States vs. Aetna Casualty & Surety Co.* (1949), 338 U.S. 366, precludes the adoption of the trustee theory, once it is established that the insured has been paid in full. That case unequivocally held that a subrogee which has paid an entire loss must sue in its own name. To our knowledge there have been no federal cases involving full payment which have deviated from the rule announced in that case. The case of *Dixey vs. Federal Compress & Warehouse Co.* (8 Cir. 1942), 132 F. 2d 275, relied upon by the plaintiff, did not constitute a deviation from the rule because the court in that case held that the plaintiff's loss had not been paid. On page 279, the opinion states:

"The Supreme Court of Tennessee has taken the view that a transaction such as disclosed by the loan receipts in the instant case, is not in fact

a loan but must be considered as payment. But we think the weight of authority sustains the holding that in the absence of evidence to the contrary such adjustments constitute loans and not payments."

But where, as here, the insured has been fully paid, the rule of *United States vs. Aetna Casualty & Surety Co.* (1949), 338 U.S. 366, *supra*, comes into play and precludes the trustee theory. This, in effect, was the decision in *Sunray Oil Corporation vs. Allbritton* (5 Cir. 1951), 187 F. 2d 475, which held that plaintiff could not recover on behalf of his workmen's compensation carrier. We quote from the opinion at page 477:

"Finding no reversible error in the record, we, therefore, affirm the judgment, except as to the recovery of \$13,084.70, which had been paid to Allbritton by the workmen's compensation insurance carrier, and which Allbritton had sought to recover on its behalf. Though it was the real party in interest, with the right to sue therefor, it was not a party to this suit, having failed and refused to prosecute it against appellant. Instead, it sought to recover without suing by agreeing with appellee that, if he would bring the suit, he could recover, and hold for it, all sums that it was entitled to recover against defendant by virtue of its subrogation rights under the laws of Texas. Appellee accordingly prayed that he recover and hold said sums as trustee, but this he could not do. He was not the trustee of an express trust in the sense of Rule 17(a), which provides that every action shall be brought in the name of the real party in interest but that the trustee of an express trust may sue in his own name without joining with him the party for whose benefit the action is brought."

In *Gas Service Co. vs. Hunt* (10 Cir. 1950), 183 F. 2d 417, the court, in holding that insurance companies

which paid part of the loss should have been joined, distinguished the federal rule requiring joinder from the rule in some states permitting the insured to sue on the theory that he is a trustee for the insurer.

In any event, the plaintiff cannot maintain this action as trustee of an express trust. If any trust exists, it must arise by implication, because no trust is expressed in Exhibit B, the loan receipt. There is a vast difference between the loan receipt in this case and the one involved in *Dixey vs. Federal Compress & Warehouse Co.* (8 Cir. 1942), 143 F. 2d 275. This loan receipt does not require the plaintiff to bring any action on behalf of the insured; on the contrary it specifically assigns plaintiff's interest to Seaboard, and contemplates that Seaboard shall bring the action. The document in the *Dixey* case imposed upon plaintiff the duty to prosecute an action against the defendant, and to pay over to the insurer any sums so collected. We quote a portion of the document, which was reproduced in full in the *Dixey* opinion:

“and we hereby agree to promptly present claim and, if necessary, to commence, enter into and prosecute suit against such person or persons, corporation or corporations, through whose negligence the aforesaid loss was caused, or who may otherwise be responsible therefor, with all due diligence, in our own name, but at the expense of and under the exclusive direction and control of the said Penn. Fire Insurance Company.”

No such duty is imposed upon the plaintiff by the loan receipt agreement in this case. This document does not contemplate that the plaintiff shall prosecute any action. Any right of action existing in the plaintiff

is by the loan receipt fully and completely assigned to the surety company, which has succeeded to all of plaintiff's rights and duties in connection therewith. Consequently, no purpose could have been served by the creation of a trust and none was expressed.

III. THE AMENDED COMPLAINT FAILS TO STATE A CLAIM UPON WHICH EITHER McNEIL OF SEABOARD CAN RECOVER.

In its first order the district court refused to bring in the Seaboard Surety Company as an additional party plaintiff, because the complaint failed to state a claim upon which either McNeil or Seaboard could recover. We quote from the portion of the opinion covering this subject, appearing in the record at page 81:

“The case of *Meyers vs. Bank of American Nat. Trust & Savings Assn.*, 77 Pac. (2d) 1987, contains a thorough discussion of the problem of when a surety, who had paid a loss under a fidelity bond, is entitled to the benefit of subrogation, and an exhaustive analysis of the cases dealing with that subject. That case points out that a surety's right to recover by way of subrogation from a third person does not stand on the same footing as its right to recover from its principal; as to the latter, that right is absolute, as to the former it is conditional. It further points out that the doctrine of subrogation has with almost unanimity been held not to apply in favor of a surety on a fidelity bond, except only as against persons who participated in the wrongful act of the wrongdoer. The ultimate holding in *Meyers vs. Bank of America* is that in a case such as the one at bar, the surety who has paid the loss has no right by way of subrogation to proceed against the bank unless there are facts from which it appears that in equity and good conscience the bank rather than the surety should

stand the loss. This holding is supported by the great weight of authority, and what is more important here, this being a diversity case, it is the law in Montana as announced in *American Bonding Co. vs. State Savings Bank*, 47 Mont. 332, 133 Pac. 367.

Therefore, Seaboard Surety Company's right to maintain an action against the defendant bank under the doctrine of subrogation depends upon the existence of equities in its favor outweighing those in favor of the bank. The possibility that such equities may exist is suggested by evidence before the Court in the affidavits which might tend to show negligence on the bank's part in cashing and charging to McNeil's account 29 purported payroll checks payable to the same individual for the same payroll period. The Court is not now concerned with the questions of whether the bank's action in this respect amounted to negligence, and, if so, whether such negligence would constitute a sufficient equity in favor of Seaboard to entitle it to maintain an action against the bank under the doctrine of subrogation, however, because the complaint in this case contains no allegations of such negligence or of any other equities that might exist in Seaboard's favor. It is the action commenced by the complaint presently on file with which the Court is concerned, and from what has been said, it is apparent that Seaboard Surety Company is not the proper party plaintiff to that action, or otherwise stated, that the present complaint does not contain sufficient allegations to state a claim upon which Seaboard can recover. While Rules 19 and 21 of the Federal Rules of Civil Procedure authorize the Court to require the joinder of an indispensable party plaintiff in an action pending before it, they do not authorize the Court to require the joinder of a party in an action where the complaint does not state a claim upon which such party can possibly recover, and therefore defendant's motion to require the joind-

er of Seaboard Surety Company as a party plaintiff is denied.”

In an attempt to circumvent the rules laid down in the cases cited by the court, the plaintiff filed its amended complaint in which it added allegations of negligence on the part of the bank. In its second order, the court dismissed the amended complaint on the ground that it also failed to state a claim upon which relief could be granted. The court's ruling in this respect is supported by ample authority in addition to the authorities cited in the opinion.

In the case of *American Alliance Insurance Co. vs. Capital National Bank* (1946), 75 Cal. App 2d 787, 171 P. 2d 449, *supra*, the plaintiff brought an action against the drawee bank to recover amounts paid on drafts presented by plaintiff's employee, upon which the employee had forged the names of the payees and appropriated the proceeds to his own use. Plaintiff was indemnified against the dishonest conduct of its employee by a surety company and was compensated for its loss by a loan receipt transaction identical to the one presented in this record. In the opinion at page 451, the court stated the respective contentions of the parties and its conclusion as follows:

“The respondent contends that the receipt previously mentioned is a mere subterfuge on the part of the surety company, and that, properly construed in the light of the weight of authorities, it shows that plaintiff was fully compensated for its losses before the commencement of this suit and therefore has no valid cause of action against the bank, and that the surety company was not entitled to be subrogated to plaintiff's rights against the bank upon payment of its losses and therefore

has no right of action against the bank which it could have assigned to plaintiff or maintained in its own name.

The appellant contends that the surety company did not pay plaintiff its losses in satisfaction of its surety liability, but, on the contrary, that it merely loaned plaintiff the money which it paid, as the receipt therefor clearly indicates, and that said receipt authorized plaintiff to, and it did, institute this action in behalf of the surety company.

We are of the opinion that, since the plaintiff was fully compensated for its loss on account of the forgeries of the drafts and the misappropriations of funds by Dietz before the commencement of the action, it could not maintain this suit in its own behalf, for to do so would result in plaintiff's receiving double pay for its losses, and that it could not maintain the action in behalf of the surety company, the indemnitor of plaintiff, since it was not entitled to be subrogated to the right of plaintiff. *Meyers vs. Bank of America, etc., Ass'n.*, 11 Cal. 2d 92, 77 P. 2d 1084."

The court then discussed the case of *Meyers vs. Bank of America* (1938), 11 Cal. 2d 92, 77 P. 2d 1084, to show that a surety company which pays a forgery loss has no right to subrogation entitling it to recover against the drawee bank. In doing so, the court stated at page 452:

"The decision in the Meyers case further quotes with approval from *First & Tri State Nat. Bank & Trust Co. v. Massachusetts Bonding & Ins. Co.*, 102 Ind. App. 361, 200 N.E. 449, as follows: 'The doctrine of (subrogation) has been applied most frequently in the courts to certain types of insurance cases. It has with almost unanimity been held not to apply *in favor of a surety on a fidelity bond*, except only against persons who partici-

pated in the wrongful act of the wrongdoer. (Citing numerous authorities.)' ”

The court then concluded that the surety company had actually paid the plaintiff and that consequently plaintiff had no right of action. If further held that the plaintiff had no standing to contend that it sued as an assignee for collection, and in that connection it made the following important statement at page 454:

“We are of the opinion that receipt of said money by plaintiff was in payment of the surety company's bonded liability in discharge of its indebtedness, and not as a mere loan. *If it was not a payment of the liability the surety company would not be entitled to subrogation and it therefore had no cause of action which could be assigned to plaintiff for collection, as we have previously held.*”

The fact that the form of plaintiff's compensation is immaterial for the purpose of this rule was more vividly demonstrated in the case of *Hensley-Johnson Motors vs. Citizens National Bank* (1953), 122 Cal. App. 2d 22, 264 P. 2d 973. This also was an action by a depositor to recover from the drawee bank for the amount of unauthorized checks cashed by one of its employees. Fireman's Fund Indemnity Company, the surety, paid the plaintiff \$1,378.64 for certain losses and agreed to pay the plaintiff \$1,285.24 on other losses with the understanding that the latter sum would be paid by it to plaintiff in the event the latter failed to recover it in an action against the defendant. The court held that the plaintiff, by reason of its agreement with Fireman's Fund, had made an election of remedies and thus could not recover against the drawee

bank. The opinion contains the following statements:

“As to the losses after August 2, when the amount of the bond was \$10,000, defendant argues that since plaintiff received \$1,378.64 from Fireman’s Fund on account of such losses and an agreement by the latter to reimburse it for the balance of the loss after that date should plaintiff not recover such balance in an action against defendant, it was reimbursed in full and plaintiff may not recover the loss after August 2 from it. Plaintiff argues it has a legal right to collect the balance of the loss after August 2, irrespective of its agreement with Fireman’s Fund.

Plaintiff’s right to recover the amount of the checks cashed after August 2, 1950, depends on the legal effect of its acceptance of \$1,378.64 from Fireman’s Fund to apply on losses which occurred after that date and the agreement of the latter to pay plaintiff \$1,285.24, the total of the two checks cashed after August 2 less the amount deposited by Marchand in the Bellflower bank, in the event plaintiff failed to recover that sum in an action against defendant.

There are two independent contracts involved: one, between plaintiff and defendant by which the latter agreed it would not pay the checks of plaintiff on forged endorsements, the other, between plaintiff and Fireman’s Fund by which the latter agreed to reimburse plaintiff for its losses. Both remedies were open to plaintiff with the limitation that there could be but one satisfaction.

Meyers v. Bank of America, etc., Ass’n., 11 Cal. 2d 92, 77 P. 2d 1084, holds that where an employer has sustained loss as a result of his employee’s forging endorsements on checks, and the employer’s surety has reimbursed him in full for the loss, the surety cannot recover from the bank since the surety has no equities superior to those of the bank. See 27 Cal. L. Rev. 88.

A number of cases hold that a bank depositor who claims that a bank has paid out his money to

a person not entitled to receive it has an election to sue either the bank or the person who received the money but that, if he chooses to sue the latter, he thereby precludes himself from suing the bank. See annotation 144, A.L.R. 1440. *No Dust O Co. v. Home Trust Co.*, Mo. App., 46 S.W. 2d 203, 207, was an action by a depositor against a bank for the aggregate of checks wrongfully cashed by its employee. The depositor-employer accepted a note and mortgage from a relative of the employee in full payment of his shortages. The court held that by accepting the note and mortgage the employer ratified the employee's 'act in cashing the checks in question at the defendant bank', citing *Cushman v. Loker*, 2 Mass. 106; *Lafitte, Dufilho & Co. v. Godchaux*, 35 La. Ann. 1161; *Ogden v. Marchand*, 29 La. Ann. 61; *Glor v. Kelly*, 49 App. Div. 617, 63 N.Y.S. 339; *McCoy v. Simon*, 64 Wash. 574, 117 P. 400; *Crute v. Burch*, 154 Mo. App. 480, 482, 135 S.W. 1004; *Lokey v. Rudy-Patrick Seed Co.*, Mo. App., 285 S. W. 1028."

And at page 978 in the opinion, the court stated:

"The effect of the agreement between plaintiff and Fireman's Fund is that plaintiff has been reimbursed in full by the surety for the losses sustained after August 2. Plaintiff, by accepting payment of \$1,378.64 from Fireman's Fund, together with its agreement to reimburse it in full, treated the money paid out after August 2 as belonging to it (plaintiff). Having treated the money as its own and having secured the agreement from the surety, it will not now be allowed to reverse its position and say the money is still in the bank. When plaintiff accepted the agreement from the surety, it waived its claim against defendant."

Another case which was cited in the *Hensley-Johnson* case, and which is directly in point, is *Liberty Mutual Insurance Co. vs. First National Bank* (Tex. Civ. App. 1951), 239 S.W. 2d 738. In that case an employee

obtained payment of checks from the drawee bank on forged endorsements. The employer recovered the defalcations from the surety on the employee's fidelity bond. The employer and the surety executed a written instrument which declared that the payment for the defalcations was an advance and that the employer would prosecute a claim against the bank and pay over such money as it recovered to the surety. The court held that the plaintiff had elected to proceed against the surety and that it had no standing in an action against the bank. The opinion stated:

"Possibly in an effort to avoid the effect of an election of remedies, appellant and the fidelity insurer executed an instrument in writing, at the time the claim on the bond was paid, which declared that the sum involved was being advanced to appellant, and that appellant would prosecute a claim against the bank at the cost and expense of the fidelity insurer, and would pay over to the latter such money as it might recover from the bank.

We are not able to see that the language of this writing changed either the form or the substance of what was done by way of making claim on the fidelity bond. It is undisputed that claim was made on the bond, and that the full amount of the defalcations was paid to appellant. Appellant elected as to the remedy it would pursue, and prosecuted the claim on the fidelity bond to a successful conclusion. To call this transaction a loan would be to ignore the realities of the situation. If, as we have held, the doctrine of election of remedies is applicable to the case, the result is that appellant waived its claim against the bank, and had no claim against the bank which it could thereafter prosecute on behalf of the fidelity insurer, or assign to it."

As is pointed out in all of these cases, it makes no difference whether plaintiff claims to be suing for his own account or as a trustee or assignee for collection. He is barred from an action on the former theory under the doctrine of election of remedies, and he has no standing to sue as an assignee for collection because the surety had no right of subrogation and therefore had no claim against the defendant which it could assign to the plaintiff.

For other cases in point, see *National Surety Company vs. Perth Amboy Trust Co.* (3 Cir. 1935), 76 F. 2d 87; and *Midland Savings & Loan Co. vs. Trademen's National Bank* (10 Cir. 1932), 57 F. 2d 686, where it was held that a depositor could not recover against the drawee bank amounts paid on forged endorsements, where it had previously recovered from its surety company.

It is clear that the amended complaint is not framed for the purpose of enforcing an alleged right of subrogation on behalf of Seaboard Surety Company. The alleged right of Seaboard to be subrogated to the rights of plaintiff is nowhere alleged or asserted, and there is no prayer for such relief in the amended complaint. Although the plaintiff has attempted to allege negligence on the part of the defendant, it has failed to assert a claim for subrogation on the basis of such negligence. Furthermore, it has not alleged the existence of equities in favor of Seaboard Surety Company outweighing those of the bank. The district court's order expressly stated that such allegations are a necessary part of Seaboard's action. The following statement appears

in 50 Am. Jur., *Subrogation*, Section 145, at page 774:

“Ordinarily, subrogation, whether sought by the plaintiff or the defendant, must be pleaded, and the facts out of which the right of subrogation arises must be set forth and proved.”

Similar comments are made in 83 C.J.S., *Subrogation*, Section 63, as follows:

“The doctrine of subrogation is not self-executing, and a person by payment does not ipso facto become subrogated to the rights of the creditor; he acquires only a right to a subrogation which must be actively asserted before subrogation can actually take place. The right of substitution and the intention, express or implied, to enforce the right must concur to make a case for subrogation.

Subrogation is a right of action only which must be established by a judicial proceeding in which two distinct sets of facts are involved, that is, those which show the right to be subrogated and those which show that the claim to which subrogation is had may be enforced against the principal.”

In any event it would be futile for the Seaboard Surety Company to attempt to assert a right of subrogation against the bank in this case, because McNeil Construction Company has no cause of action to which the surety can become subrogated. This is so because McNeil proceeded against the forger (through his surety) and recovered from that source before proceeding against the bank. As the district court pointed out in its order, the surety company stands in an entirely different position in this case as distinguished from a case where it is suing the principal debtor. The court observed the fact that the doctrine of subrogation has with almost unanimity been held not to apply in favor

of a surety on a fidelity bond, except only as against persons who participated in the wrongful act of the wrongdoer. The reasons for this are obvious: the surety company undertook for profit to guarantee the acts and doings of the very person who caused the loss; furthermore, there is available to it, under a proper application of the doctrine of subrogation, an action against the wrongdoer.

Here it is not even intimated that the bank participated in the wrongful act of the employee who forged the checks. The action is based upon an alleged right of McNeil Construction Company to recover for negligence of the bank in honoring the forged checks. Any right of action which McNeil might have had on this theory has been extinguished by virtue of McNeil's election to proceed against the surety, and by payment in full. Since McNeil has no action against the bank in its own behalf, there is nothing to which Seaboard Surety can become subrogated.

IV. CONCLUSION

In conclusion, we submit that the Order and Judgment of the district court should be affirmed for the following reasons:

1. Appellant has no standing to complain of any alleged error committed by the court prior to the time that appellant voluntarily filed its amended complaint.

2. The district court's interpretation of Montana law, on the question whether the loan receipt constituted payment, should be upheld because it is not mani-

festly contrary to any decisions of the Montana supreme court.

3. Appellant is not the real party in interest and may not maintain this action on the theory that it is the trustee of an express trust.

4. The amended complaint does not state a claim upon which either the appellant or Seaboard Surety Company can recover.

Respectfully submitted,

LUXAN & SCRIBNER
A. W. SCRIBNER
Attorneys for Appellee

United States Court of Appeals

For the Ninth Circuit

McNEIL CONSTRUCTION COMPANY,
a corporation,

Appellant,

v.

THE LIVINGSTON STATE BANK,
a corporation,

Appellee.

Appellant's Brief

Appeal from the United States District Court for the
District of Montana.

BROWN, SANDE, SYMMES & FORBES
Attorneys at Law
Suite 200, First National Bank Bldg.
Billings, Montana

WEYMOUTH D. SYMMES, of Counsel
Attorneys for Appellant.

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Attorneys for Appellant.

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Appellant's Brief

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District of Montana.

I.

JURISDICTION

This is an appeal from a final order of District Judge W. D. Murray dismissing the amended complaint in this action before joinder of issue and on defendant's motion on the ground that plaintiff is not the real party in interest (R. 89-91). For convenience Appellant will be referred to either as "plaintiff" or "McNeil" and Appellee as "defendant". Jurisdiction is based on diversity of citi-

zenship (28 U.S.C.A. 1332), the plaintiff being a California corporation (R. 10, 20) and the defendant being a Montana banking corporation (R. 11, 20). The amount in controversy exclusive of interest and costs exceeds \$3,000.00 (R. 5, 21). This Court has appellate jurisdiction under 28 U.S.C.A. 1291.

II.

THE QUESTIONS PRESENTED

There are two decisions of the District Court involved on this appeal. One, dismissing the original complaint with leave to plead over (R. 74-84). The second was a final order dismissing the amended complaint (R. 89-91). This action is one brought by plaintiff as a depositor of the defendant to recover the amount paid by defendant from plaintiff's account on 29 forged payroll checks. Plaintiff had a contract of insurance with Seaboard Surety Co. covering the loss. Seaboard, however, instead of paying the loss and being subrogated, loaned the money to plaintiff, which in turn executed a loan receipt agreement, a copy of which is set forth on pages 37 to 39 of the Record. Thereafter, plaintiff filed this suit.

The District Court held in dismissing the first complaint that it would not recognize loan receipt agreements as such; that, on the contrary, the loan was in fact payment; it reserved decision on the question of whether McNeil could maintain the action as trustee of an express trust and held that no equities were pleaded sufficient to show Seaboard should recover, although ex-

istence of such equities appeared in affidavits; and that plaintiff should plead over showing its equitable right to relief. The Court in its second decision dismissing the amended complaint held that McNeil could not maintain this action as trustee of an express trust under Rule 17 (R. 90).

These two rulings of the Court present the primary problems before this Court on this appeal. The basic mistake made by the District Court, and which probably had a decisive influence on its decision, was in assuming that through the device of a "loan receipt" the plaintiff and its surety could avoid equitable defenses which would be available against the Surety but not the insured. Such is not our contention, and it is unnecessary to determine this question in disposing of this appeal. Admitting for the sake of argument that these defenses are available, we claim the loan receipt enables plaintiff to maintain this suit and that the undisputed facts show that defendant's gross carelessness entitles plaintiff to summary judgment. *American Surety Co. v. Bank of California*, 133 Fed. (2d) 160 (C. A. 9th, 1943).

III.

STATEMENT OF THE CASE

A. THE ORIGINAL COMPLAINT

The complaint originally filed in this action alleged:

1. Plaintiff, a California corporation, deposited with defendant, a Montana banking corporation, a sum in excess of \$5,000.00 in a checking account for the purpose, among other things, of drawing on said amount for wages to be paid to employees of the plain-

tiff. Between September 13, 1956 and September 28, 1956, the plaintiff employed one Lex Lamb as a night-watchman and that unknown to the plaintiff, Lamb stole 400 blank payroll checks numbered 8401 to 8800, inclusive, from offices maintained by the plaintiff in Yellowstone National Park where the plaintiff was doing construction work (R. 4).

2. On September 26, 1956 Lamb forged the plaintiff's name to 29 of the checks stolen, each in the sum of \$143.04; Lamb then cashed the checks which were paid by the defendant from funds on deposit with the defendant by the plaintiff in the total sum of \$4,148.16. The Livingston State Bank was advised of the theft of the 400 payroll checks and the forgery of 29 thereof on or about October 26, 1956, which was within thirty days after the discovery by the plaintiff of the theft of the checks, and that the defendant refuses to refund to the plaintiff the said sum of \$4,148.16, which is due and owing to the plaintiff from the defendant. Damages in that amount are demanded together with interest at the rate of six per cent (6%) from November 1, 1956 (R. 5).

B. *DEFENDANT'S MOTION*

The defendant appeared generally by motion to: (a) dismiss the action pursuant to Section 1406 of Title 28 of the United States Code on the ground that the action is filed in the wrong division (R. 6); (b) dismiss the action because the complaint did not state a claim against the defendant upon which relief could be granted (R. 6); (c) transfer the action from the Billings Division where it was originally filed to the Helena Division pursuant to Section 1406 of Title 28 of the United States Code (R. 6); and (d) require the joinder of Seaboard Surety Company as a party plaintiff on the ground that Seaboard Surety Company was the real party in interest (R. 7).

This last phase of the motion to require the joinder of Seaboard Surety Company was based upon an affidavit submitted with the motion stating on information and belief that the plaintiff had a contract of insurance with Seaboard Surety Company and that Seaboard had paid the loss and was subrogated to the rights of the plaintiff (R. 8-9).

The plaintiff filed an affidavit in opposition to the latter portion of the motion (R. 33). This affidavit admitted that Seaboard Surety Company issued an indemnity bond on behalf of the plaintiff but alleged that no payment had been made by Seaboard under this bond, but that on the contrary Seaboard Surety Company had loaned \$4,148.16 to McNeil Construction Company pursuant to a loan receipt agreement, a copy of which is set forth on pages 37 to 39 of the Transcript.

C. PLAINTIFF'S REQUEST FOR ADMISSIONS

Immediately after defendant's appearance, plaintiff served and filed a Request for Admissions asking the defendant to (1) admit formal allegations; (2) admit that the checks were forged; (3) admit that they were paid by defendant; (4) admit that Lex Lamb, an employee of McNeil, was the forger; and (5) admit the genuineness of letters from the defendant to the plaintiff (R. 10-19).

D. THE DEFENDANT'S RESPONSE TO THE REQUEST FOR ADMISSIONS

The defendant admitted some, but not all, of the requests filed by the plaintiff (R. 20). It claimed that it was unable to truthfully admit or deny that the 29 pay-

roll checks were forged and that it was impossible for the defendant to secure the necessary information by reasonable inquiry (R. 21). This denial was made despite the fact that each of the 29 payroll checks cashed by the defendant were payable to the same individual; each for the same amount; each for the same payroll period (R. 16, 17, 21, 30-33); each was dated either September 25 or September 26 (R. 16). The defendant also stated that it was unable to either truthfully admit or deny that Lex Lamb admitted to agents of the Federal Bureau of Investigation that he had stolen the 400 payroll checks and forged plaintiff's name to 29 of them (R. 22). The defendant likewise claims that it was impossible for them to secure the necessary information from the FBI by reasonable inquiry (R. 23).

E. *THE PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT*

Before defendant's various motions referred to in subdivision B above were argued, the plaintiff filed a Motion for Summary Judgment based upon the affidavits of Lexington Lamb, R. H. Westland and Weymouth D. Symmes. Lamb's affidavit (R.24), obtained by plaintiff because of defendant's frivolous refusal to admit that Lamb forged these checks, asserted that he was employed by the McNeil Construction Company in September, 1956, for two or three weeks as a nightwatchman, ambulance driver, and switchboard operator, and that he left this job voluntarily at the end of one of his shifts by merely leaving at the end of the job, and that prior to

leaving McNeil and while he was still on McNeil's payroll, he took a number of blank payroll checks from McNeil, made out 29 or 30 of them payable to Lex Lamb, each for \$143.04, forged McNeil's name to the checks, and cashed them at various places (R. 24-26).

Westland's affidavit (R. 27) asserted that he was project manager of the McNeil Construction Company for certain work being conducted in Yellowstone National Park in September, 1956. That during this period of time the company maintained offices at or near Canyon Village in the Park. He also asserted that "In the construction business there is a rapid turnover of workmen by reason of the fact that most workers employed by construction companies are transients." That Yellowstone National Park has no permanent residents or inhabitants capable of being hired to do the necessary manual labor, and that as a consequence when workmen are employed it is virtually impossible to check upon their back records. That Lamb was employed from September 13, 1956 to September 27, 1956, that he had a Social Security Card. That McNeil Construction Company's checks were kept in a four-drawer file cabinet in the timekeeper's office, that during the daytime when construction work was going on this office was always occupied by trusted employees, and that every evening and night the only access to this office was through a locked door or window or a small pass window; that on October 26, 1956, he received a phone call from Mr. Coghlund, an employee of the defendant, advising the affiant that

he had two payroll checks which he "thought" were forged. Upon receiving this phone call an immediate examination of blank checks was made and one package was missing which included checks numbered 8401 to 8800, and that this was the first notice they had that their printed payroll checks had been stolen (R. 27-29).

Symmes, in his affidavit (R. 30), asserted that he had 28 of the 29 forged payroll checks in his possession. Each check was for \$143.04; that from an examination of the checks the first check received by The Livingston State Bank was number 8650 and it was dated September 25, 1956; it recited that the payee's badge number was 77631, that it was for the pay period ending "9-26-56" payable to the order of "Lex Lamb." It was received by the bank on or before October 1, 1956, and was stamped paid on "10-1-56". That on October 2, 1956, the bank received three identical checks, each payable to Lex Lamb, each in the sum of \$143.04, each dated September 25, 1956, except one which was dated September 26, 1956, and each recited on their face that they were for the pay period "9-26-56", each was endorsed by "Lex Lamb", each was stamped "paid 10-2-56". On October 3, 1956, eight of these checks cleared through The Livingston State Bank, each was marked paid on the same date, each was dated September 26, 1956, each was payable to the order of Lex Lamb, and each was for the payroll period ending "9-26-56". On October 4, 1956, six checks were stamped paid by The Livingston State Bank on "10-4-56", each was payable to the order of Lex Lamb in the sum of

\$143.04, each was for the pay period ending "9-25-56". On October 5, 1956, three checks identical to the checks heretofore described were stamped paid by The Livingston State Bank, each was for the same amount, each was for the same payroll period. On October 6, 1956, three more checks were stamped paid by The Livingston State Bank, each identical to the foregoing checks, each payable to Lex Lamb, each for the identical amount, and each for the same payroll period. On October 6, 1956, three more of the checks cleared the bank and were stamped paid on that date. On October 9, 1956, four checks identical to the foregoing were stamped paid by the bank and that the 29th check was not in deponent's possession (R. 30-33). All of these checks are before this Court in their original form.

F. *THE AFFIDAVIT IN OPPOSITION TO
PLAINTIFF'S MOTION FOR SUMMARY
JUDGMENT*

The defendant submitted one affidavit in opposition to the Motion for Summary Judgment. The substance of the affidavit was, first, that the defendant did not have time to obtain the facts because only (R. 42) "three months" have elapsed since the date the action was commenced; second, that plaintiff was guilty of negligence in employing Lamb, which was the proximate cause of its loss, although no facts were set up in support of this contention (R. 43); third, that the real party in interest was Seaboard Surety Company (R. 45); and fourth, that prior to the loss Seaboard Surety Company had issued

to plaintiff a "general depositors forgery bond," which not only indemnified the plaintiff but also its depository banks (R. 45), although it admitted the bond did not cover losses caused by the fraud of an employee. (R. 45).

G. *PLAINTIFF'S SUPPLEMENTAL AFFIDAVIT IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT*

After receiving the affidavit submitted in opposition to the plaintiff's Motion for Summary Judgment, it filed a supplemental affidavit signed by F. V. O'Brien (R. 46), superintendent of claims of Seaboard Surety Company, which alleged in substance that Seaboard had issued to McNeil two bonds, copies of which were attached to the affidavit. The first bond was a blanket position bond issued by Seaboard Surety Company to McNeil Construction Company. This bond did not underwrite depository banks but provided that Seaboard agreed to indemnify McNeil for any loss caused by the theft or other dishonest act of any employee "through any fraudulent or dishonest act or acts committed by any one or more of the employees *** during the term of this bond *** or within thirty days after leaving the service of the insured." (R. 48). Admittedly the dishonest acts occurred within this thirty-day period. This bond did not protect depository banks. The other bond was a depositors forgery bond, and, by its terms, did not cover acts of McNeil's employees, although it did run to depository banks. (R. 69).

IV.

THE THREE DECISIONS OF THE DISTRICT COURT

All of these motions were first presented to District Judge W. J. Jameson, who (1) granted the defendant's Motion for a Change of Venue and ordered the transfer of the action to the Helena Division; (2) denied defendant's Motions to Dismiss; and (3) declined to rule upon the plaintiff's Motion for Summary Judgment in view of the fact that the case was being transferred to another division before another judge (R. 72, 73). The decision of Judge Jameson is reported in 155 Fed. Supp. 658. We assign no error for any ruling of Judge Jameson in that decision.

The motion left pending by Judge Jameson's decision was then considered by Judge W. D. Murray, who, among other things (160 Fed. Supp. 809), granted defendant a conditional summary judgment (R. 84), though no such application had been made, with leave to the plaintiff to amend its complaint (R. 74-84) stating, first, that he would not recognize the loan receipt as such, but only as payment of McNeil in full, and, second,

"If McNeil is bringing the action as a trustee of an express trust under the loan receipt, it is Seaboard Surety Company's action that it is bringing and as pointed out above under *Meyers v. Bank of America*, supra, and *American Bonding Co. v. State Savings Bank*, supra, cases, a necessary part of Seaboard's action, if any, is allegations and proof of equities in favor of Seaboard outweighing those in favor of the defendant bank, and the complaint is devoid of such allegations.

"Therefore, because from everything that is before the Court it appears that there may be equities in favor of Seaboard which entitle it to recover, and because McNeil has suggested the possibility that it should be permitted to make the recovery on behalf of Seaboard as a trustee of an express trust, and in the interest of justice, McNeil Construction Company is granted twenty days within which to file an amended complaint, otherwise summary judgment will be ordered for defendant."

We know of no case or Rule approving or authorizing conditional summary judgment in view of the fact that summary judgment is a decision on the merits. In granting judgment the Court necessarily took into consideration facts extrinsic to the complaint contained in affidavits (Seaboard's "loan"), but ignored the extrinsic facts in those same affidavits showing equities in favor of Seaboard against defendant. The Court likewise ignored Rule 8(a) (2) of the Federal Rules of Civil Procedure. In 1 Fed. Prac. & Proc., Barron & Holtzoff, Sec. 255, p. 431, it is stated:

"Under Rule 8(a) (2), only 'a short and plain statement of the claim showing that the pleader is entitled to relief' is required. If the claim for relief is stated with brevity, conciseness and clarity, this is all that is necessary. This provision indicates clearly the intention of the rules to avoid technicalities and to require only that the pleading give the opposing party fair notice of the nature and basis or grounds of the claim and a general indication of the type of litigation involved. Pleadings are liberally construed under Rule 8(f) and a complaint is not subject to dismissal unless it appears to a certainty that no relief can be granted under any set of facts which can be proved in support of its allegations."

The nature of the decision under consideration and the act of the Court in granting defendant a conditional summary judgment without any application on the part of the defendant, put the plaintiff in a precarious position. If the plaintiff refused to amend and permitted judgment to be entered, that judgment would have been a judgment on the merits which would have precluded both McNeil and Seaboard from again filing suit if, on appeal, this Court should affirm. *Celanese Corp. v. John Clark Industries*, 214 Fed. (2d) 551, (C. A. 5th 1954).

The Court overlooked the fundamental rule heretofore uniformly applied by all courts considering summary judgment that

“On a Motion for Summary Judgment, the formal issues presented by the pleadings *are not controlling and the Court must consider the affidavits and other matters presented by the parties to determine whether the motion should be granted.* *** On such a motion the Court considers the entire setting of the case and all papers of record. The pleadings as a whole, and not merely the complaint, are considered. In addition to the pleadings, the Court considers affidavits, admissions, stipulations, depositions, and answers to interrogatories.” (Italics ours)

3 Fed. Prac. & Proc., Barron & Holtzoff,
Sec. 1236, p. 89.

In the same volume of Federal Practice & Procedure Section 1240, p. 105, it is stated:

“A motion to dismiss for lack of jurisdiction, improper venue, insufficiency of process, insufficiency of service, and failure to join an indispensable party contemplates a dismissal of the claim and not a judgment on the merits for either party. A motion to dismiss for failure to state a claim upon which relief can

be granted, besides asking for a dismissal, is by its terms a contention that the pleading to which it is addressed does not in itself sufficiently state a claim for relief. A motion for judgment on the pleadings is based upon the ground that the moving party is entitled to a judgment on the face of the pleading themselves. On the other hand, a party moving for summary judgment contends that on the basis of the entire record—pleadings, depositions, admissions, and affidavits of both parties—there is no genuine issue as to any material facts and that he is entitled to a judgment as a matter of law.”

In view of the foregoing, it can be seen that the District Court precluded the plaintiff from risking the entry of judgment and testing the validity of the Court’s decision that a loan receipt agreement would not be recognized as such but was, in fact, payment, for the decision had the legal effect of not only granting the defendant summary judgment against McNeil Construction Company but also summary judgment against Seaboard Surety Company. Barron and Holtzoff, *supra*, and the *Celanese Corp. Case* *supra*. In view of this fact, the plaintiff had no alternative but to file an amended complaint.

The amended complaint specifically alleged negligence on the part of The Livingston State Bank in cashing these 29 payroll checks, and, compelled by the Court’s order, alleges in substance that McNeil Construction Company was bringing this action on behalf of Seaboard Surety Company as trustee of an express trust. After the amended complaint was filed, the defendant again made a motion to (1) dismiss the action because the amended

complaint did not state a claim against the defendant upon which relief could be granted, and (2) alternatively, to require the joinder of Seaboard Surety Company as a party plaintiff. By summary order the Court did not consider the alternative of compelling joinder of Seaboard but granted defendant's motion to dismiss the complaint because (R. 89, 90),

"The Court is of the opinion that the amended complaint does not state a claim upon which relief can be granted to McNeil Construction Company as trustee of an express trust for Seaboard Surety Company.

"The Court is further of the opinion that the provision of the loan receipt agreement which McNeil Construction Company contends makes it a trustee of an express trust for Seaboard Surety Company, does not have that effect. Therefore, not only does the amended complaint fail to state a claim upon which relief can be granted to McNeil Construction Company upon the theory of an express trust, but it is also impossible for McNeil Construction Company to state a claim because the loan receipt agreement does not constitute McNeil an express trustee for Seaboard."

V.

SPECIFICATIONS OF ERROR

1. The Court erred in dismissing the original complaint.
2. The Court erred in dismissing the amended complaint.
3. The Court erred in denying plaintiff's Motion for Summary Judgment.

VI. ARGUMENT

1. *The Court Erred in Refusing to Recognize Loan Receipt Agreements as Such.*

In Volume 3 of Moore's Federal Practice, p. 1349, par. 1709, it is stated:

"An insurer which has merely made a 'loan' to an insured, to be repaid out of any recovery from a third party, is not a real party in interest in an action by the insured against a third party."

In 2 Federal Practice & Procedure, Barron & Holtzoff, Sec. 482, p. 13, it is stated:

"If, instead of paying the loss, the insurer makes a loan to the insured under an agreement whereby the loan is to be repaid only out of any recovery which may be obtained against a third person, the insured and not the insurer is the real party in interest and entitled to sue the third person."

There are many cases that support the validity of and recognize loan receipt agreements of the same type used by Seaboard Surety Company and McNeil in the case at bar. As the cases hold, there are compelling equitable and commercial reasons sustaining the validity of loan receipts. First, the insured is promptly paid; second, insurance companies usually do not fare too well before juries when they are parties to a suit.

*Merrimack Mfg. Co. v. Lowell
Trucking Corp.*
46 N.Y. Supp. (2d) 736,
182 Misc. 947 (1944).

In *Celanese Corp. v. John Clark Industries*, 214 Fed. (2d) 551, (C.A. 5th 1954), action was brought by the

plaintiff against defendant to recover damages for a fire loss suffered by the plaintiff due to the negligence of the defendant. Among other things, the defendant claimed that certain named insurance companies with whom the plaintiff had executed loan receipt agreements were indispensable parties and should be named as plaintiffs in the suit. The Court rejected this contention, recognized loan receipts as a loan and not payment, and held (p. 556):

“Since it is clear from the record that the suit was properly prosecuted by plaintiff under loan receipts, it is also clear that the insurance companies were neither indispensable nor necessary parties, and that, while the action of the court in permitting them to intervene in the suit was neither necessary nor proper, the defendant took no prejudice therefrom. The Clark Company was, under the undisputed facts of record, the real party at interest in the sense of the rule governing suits filed under loan receipt procedure, but if they were proper parties, the defendant has suffered no legal wrong from the way the cause was tried.

“As appellant points out in its brief, the purpose of the practice long obtaining in the federal courts and now set forth in Rule 17 of the Federal Rules of Civil Procedure, 28 U.S.C.A., that every action shall be prosecuted in the name of the real party in interest, is to enable the defendant to avail himself of evidence and defenses that the defendant has against the real party in interest, and to assure him finality of the judgment, and that he will be protected against another suit brought by the real party at interest on the same matter.

“In the light of the real meaning of the rule, if the insurance companies were proper parties, the defendant has suffered no legal wrong from the way the

cause was tried. It was not deprived of offsets or defenses it might have had against them. It was understood by all that the counsel for the insurance companies were in active conduct of the suit and the judgment entered would have barred them whether or not they were actually in the cause, so that defendant was at no time concerned with the question of lack of finality of the judgment or the possibility of its being again sued. Its real, its only concern was not to have the insurance companies brought into the suit to protect itself against being again sued or with respect to offsets or claims against them but for the possible prejudice which plaintiff might suffer in the minds of the jury because of the knowledge that plaintiff was insured. Such a purpose is neither a proper nor a legal purpose. The courts have uniformly condemned it."

Among other cases recognizing the validity of loan receipts are the following:

Luckenbach v. W. J. McCahan Sugar Refining Company,
248 U. S. 139,
39 S. Ct. 53,
63 L. Ed. 170.

Augusta Broadcasting Company v. United States,
170 Fed. (2d) 199 (CA 5th 1948).

Dixey v. Federal Compress & Warehouse Company,
132 Fed. (2d) 275, (CA 8th 1942).

Western Fire Insurance Company v. Word,
131 Fed. (2d) 541, (CA 5th 1942).

Hartford Fire Insurance Company v. Commercial Union Assurance Company,
131 Fed. Supp. 751 (DC N.Y. 1955).

Williams v. Union Pacific Railway Company,
94 Fed. Supp. 174 (DC Neb. 1950).

*Capo v. C-O Two Fire Equipment
Company,*
93 Fed. Supp. 4 (DC N.J. 1950).

There is an annotation in 157 A.L.R. beginning at page 1261 which discusses loan receipts and which lists at page 1263 the many authorities supporting the validity of loan receipts. The annotator draws a conclusion evidently relied upon by the District Judge in the case at bar that whether a loan receipt is declared to be a loan or a payment depends upon the intent of the parties even though the instrument specifically recites that it is a loan. In this connection, we do not agree with the conclusions drawn by the annotator and we do not think the cases which he relies upon for his position are authority for that proposition at all as we shall hereafter point out in more detail. However, even assuming that the annotator is correct in his conclusions, it should be noted in the case at bar that the loan from the insurer to the insured was the exact amount of the loss, and that in the complaint at bar the insured is seeking to recover not only the amount of the loan but interest on the amount from November 1, 1956. In addition to this fact, the blanket position bond itself provided (R. 48)

"In consideration of an agreed premium, Seaboard Surety Company, a corporation of the State of New York, *** hereby agrees to indemnify McNeil Construction Company of 5858 Wilshire Boulevard, Los Angeles, California, *** against any loss of money *** *which the insured shall conclusively prove has been caused by the fraud or dishonesty of any employee or employees belonging to the insured, or in*

which the insured has a pecuniary interest, ***." (Italics supplied).

The District Court admitted that no Montana decisions existed deciding the particular point involved here. The Court, however, speculated as to what the Montana Court would do and stated in substance that in the District Court's opinion Montana would refuse to recognize loan receipt agreements as such. The only Montana case that we have been able to find which sheds any light on the problem tends to favor the position that McNeil has taken in the case at bar. In *Rae v. Cameron*, 114 Pac. (2d) 1060, 112 Mont. 159, the Supreme Court of Montana held that all that was necessary to constitute a plaintiff the real party in interest was that he be vested with the legal title and hence that an assignee of an account for collection only could maintain action in his own name. The Court held:

"Under this treatment of the cases, the law of this state is necessarily back in its rightful orbit, which is, as announced in *Genzberger v. Adams*, 62 Mont. 430, 205 Pac. 658, that all that is necessary to constitute a party plaintiff the real party in interest within the provisions of Section 9067 is that he be vested with the legal title. The Court there was dealing with an action by an assignee of a judgment who was suing for the benefit of another. We again adhere to that rule, and anything to the contrary appearing in *State ex rel Freeborn v. Merchants Credit Service*, *Streetbeck v. Benson*, and *Northern Montana Association v. Hauge*, all *supra*, is expressly overruled."

This decision would clearly indicate that Montana would permit this plaintiff to maintain this action.

Moreover, in *Dixey v. Federal Compress & Ware-*

house Company, 132 Fed. (2d) 275 (CA 8th 1942), the Court held in a case involving a settlement of a claim for a fire loss under a loan receipt that nevertheless title to the claim of the insured for the amount of the loss remains in the insured with a beneficial interest running to the insurer and therefore the insured holds the claim as the trustee of an express trust. See Rule 17 Federal Rules of Civil Procedure.

In *United States v. Aetna Casualty & Surety Company*, 338 U.S. 366, 94 L. Ed. 171, 70 S. Ct. 207, the Court considered whether “an insurance company” could bring suit in its own name against the United States on a claim to which it had become subrogated by payment to an insured, who in turn would have been able to bring such action. The problem of loan receipts was not considered by the Court, but there were some interesting observations which should be helpful to this Court in resolving the problem presented by this appeal. The Court said:

“In cases of partial subrogation the question arises whether suit may be brought by the insurer alone, whether suit must be brought in the name of the insured for his own use and for the use of the insurance company, or whether all parties in interest must join in the action. Under the common-law practice rights acquired by subrogation could be enforced in an action at law only in the name of the insured to the insurer’s use, *Hall & Long v. Nashville & C.R. Cos.* (US) 13 Wall 367, 20 L. ed. 594 (1872); *United States v. American Tobacco Co.* 166 US 468, 41 L. ed. 1081, 17 S. Ct. 619, *supra*, as was also true of suits on assignments, *Glenn v. Marbury*, 45 US 499, 36 L. ed. 790, 12 S. Ct. 914 (1892). Mr. Justice Stone

characterized this rule as 'a vestige of the common law's reluctance to admit that a chose in action may be assigned, (which) is today but a formality which has been widely abolished by legislation.' *Aetna Life Ins. Co. v. Moses*, 287 US 530, 540, 77 L. ed. 477, 481, 53 S. Ct. 231, 88 A.L.R. 647 (1933). Under the Federal Rules, the 'use' practice is obviously unnecessary, as has long been true in equity, *Garrison v. Memphis Ins. Co.* (US) 19 How 312, 15 L. ed. 656 (1857), and *Admiralty, Liverpool & Great Western Steam Co. v. Phenix Ins. Co. (The Mountain)* 129 US 397, 462, 32 L. ed. 788, 799, 9 S. Ct. 469 (188). Rule 17 (a) was taken almost verbatim from Equity Rule 37. No reason appears why such a practice should now be required in cases of partial subrogation, since both insured and insurer 'own' portions of the substantive right and should appear in the litigation in their own names."

In any event, the District Court in its decision relied upon two California cases in refusing to recognize loan receipt agreements. The cases were *Meyers v. Bank of America*, 77 Pac. (2d) 1084, and *American Alliance Insurance Company v. Capital National Bank*, 171 Pac. (2d) 449. An analysis of these cases will reveal that the problem before this Court in the case at bar did not confront the California courts in deciding these cases. *The real holding in both of these cases was that a device such as a loan receipt or assignment of a cause of action cannot deprive the defendant of the equitable defenses it might have against the surety, even though such defenses would not ordinarily be available against the insured.*

We do not challenge these rulings. Here, we claim (1) the admitted facts show that the equities favor not only plaintiff but also its surety, and (2) in any event, there

was no basis either in law or in fact for dismissal. In the *Meyers* case, plaintiff's office manager received certain checks payable to the plaintiff. The office manager then forged the name of the payee by way of endorsement, negotiated them to one Wascher, who paid the full value therefor, and who in turn deposited them in his bank account with the defendant bank, which thereafter presented the checks to the respective drawees and received full payment therefor. The plaintiff was indemnified by the United States Guarantee Company and was paid in full. No loan receipt agreement was issued by the plaintiff; on the contrary, the plaintiff assigned to the bonding company any cause of action which it then had, together with the right to maintain an action at law in the name of the plaintiff. There are other equally valid grounds for distinguishing this case from the case at bar. First, unlike the case at bar there was no debtor-creditor relationship between the plaintiff and the defendant bank. Second, there were no equitable reasons for the bank to bear the loss rather than the insurer. In the case at bar not only was there a loan receipt agreement between the plaintiff and the insurer, but also the defendant bank was in a position to have avoided the loss by detecting the forgeries, as it certainly should have been able to do by a comparison of signatures. In addition, these 29 forged payroll checks, all payable to the same individual, all for the same payroll period, all in the same amount, were cashed by the bank in a period of ten days, which we submit is conclusive evidence of negligence on the part of the bank,

which would entitle either the plaintiff or the Seaboard Surety Company to recover in this action.

The *American Alliance Insurance Company* case, although involving a loan receipt, is distinguishable from the case at bar for the reason that the forgeries involved there were made by a trusted employee. He was a special agent of the plaintiff and was clothed with full authority from the plaintiff to present drafts to the bank and to receive the payment therefor. There was absolutely no proof of negligence on the part of the bank. As a matter of fact, it affirmatively appeared that it was plaintiff's own negligence in giving its agent authority which enabled him to promote the fraud that brought about the loss. Under these circumstances neither the plaintiff nor its insurance carrier could recover from the bank.

In *Merrimack Mfg. Co. v. Lowell Trucking Corporation*, 46 N. Y. Supp. (2d) 736, 182 Misc. (2d) 947, (1944), the Court considered the equitable and commercial reasons for recognizing loan receipts, stating:

"The 'Loan Receipt' is a device by the use of which insurance may be paid to avoid some of the consequences of subrogation. Whatever reasons there may be of a business character for the insurance company shying away from subrogation, there is one of great significance which manifests itself when the contracting parties appear before a court and jury. Insurance companies by experience find that when their financial interest is discovered by a trial jury in a suit they fare not so well. In their reluctance to reveal their presence in litigation, insurance carriers do not stand alone. The courts have decided times without number that the unnecessary disclosure to the jury of the presence of a liability insurance company in a negli-

gence trial warrants a mistrial; when selecting the jury in negligence cases, the fact of liability insurance in the suit may not be brought to the jury's notice and only certain limited questions defined by the Legislature, Section 452, Civil Practice Act, calculated not to reveal the fact, may be asked.

"Many trials have their moments when the words 'Insurance Company' have either been mentioned, inferentially suggested or in some form disturbed the impartial composure of the court room where fair play is necessarily the wholesome atmosphere. Sensitive to the effect of that information falling upon the ears of the jurors, the court often ponders upon its own motion what action to take. Times are when counsel are rendered mute by the unexpected incident. The attorney affected detrimentally, satisfied to risk his chances on the evidence in the case, hesitates to speak lest his quest be denied and that which was only suggested is projected with all of its force to influence the jury, he fears, to allot something to the plaintiff, based on the convenient premise which disregards evidence 'it will not hurt the defendant and that insurance company will never feel it.'

"That the disclosure of the fact of insurance in a case is a disadvantage to one side is, if this court's observations have been accurate, universally understood by experienced trial lawyers. Divulgence of the fact by accident or design has been guarded against by trial judges over many years and the vice of letting the jury know about it has to a degree statutory recognition. Section 452, Civil Practice Act.

"Those who devised the 'Loan Receipt' which permits the insurance company to speedily pay its insured and yet press in court to recoup its losses from the wrongdoer without the company appearing by name, trying in that way to avoid unmerited disadvantages difficult to surmount, were not unrealistic. Defendant's attorney declares that the fears of his adversary about the attitude of juries toward insurance companies are unfounded. He states that his representa-

tion of insurance carriers has been of long duration and openly avowed. He implies that although the juries knew that his insurance company clients were involved, those clients have not been ill treated. Counsel's view that juries do not on occasion make distinctions not warranted by evidence, cannot be shared by this court despite this court's enthusiasm for the trial by jury as an effective agency of justice. Counsel's accomplishments under the circumstances ornament his brilliant record as a practitioner of which this court has personal knowledge.

"Should the court upon piercing the mantle of the 'Loan Receipt' and discerning its clear objective, enforce the letter of Section 210, Civil Practice Act, and thus condemn the practice of using Loan Receipts?"

"Business men endeavor by the use of the 'Loan Receipt' to accelerate payment of insurance claims so that industry will not be stifled for the want of goods or the money equivalent while responsibility for torts related to the payment is being determined. The first (payment of claim can and should be disposed of with celerity because the loss ordinarily fixes liability and decides all questions. The second (determining responsibility for the tort) may be speeded only at the expense of justice. Withholding indemnity from the insured pending determination of litigation might force a settlement based not upon the merits of the claim but upon the need for funds. That practice penalizes the poor. It would seem that the 'Loan Receipt' fills a needed dual capacity."

For the foregoing reasons, we respectfully submit that plaintiff and Seaboard could properly use a loan receipt, and action could be brought in McNeil's name. The Court, therefore, erred in dismissing both the original and amended complaints.

2. The Plaintiff's Motion for Summary Judgment Should Have Been Granted.

The facts involved in this case are undisputed. No issues are raised by any reply affidavit; no claim is made in the answering papers that any fact set forth in the affidavits submitted in support of the Motion for Summary Judgment are false. *Section 5-1007, R.C.M., 1947*, provides as follows:

“Liability of bank paying forged check. No bank shall be liable to a depositor for the payment by it of a forged or raised check unless, within thirty days after the receipt by the depositor of the voucher of such payment, such depositor shall notify the bank that the check so paid is forged or raised.”

It is undisputed that this Section of the Revised Codes of Montana was complied with by the plaintiff. We submit that under the admitted facts disclosed here defendant is liable as a matter of law under the theory that the equities favor plaintiff and its surety company. As this Court said in *American Surety Co. v. Bank of California*, 133 Fed. (2d) 160, p. 162:

“A surety may pursue the independent right of action of the original creditor against a third person, but it must appear that said third person participated in the wrongful act involved *or that he was negligent, for the right to recover from a third person is merely conditional in contrast to the right to recover from the principal which is absolute.*” (Emphasis supplied).

Cf: *United States Fidelity & Guarantee Company v. First National Bank in Dallas*, 172 Fed. (2d) 258, (C.A. 5th 1949);
American Bonding Co. v. State Savings Bank,
 47 Mont. 332, 133 Pac. 667.

We should have been granted summary judgment

even if the Court should conclude that the plaintiff may not recover unless there are facts from which it appears that in equity and good conscience the bank, rather than the surety, should stand the loss. Even under this doctrine neither the plaintiff nor its surety company should be required to stand this loss. Twenty-nine payroll checks were cashed by the defendant in a period of ten days; each of the checks was dated either September 25 or 26, 1956; each check was payable to Lex Lamb; each check was for the same amount; each check was for the same payroll period. These facts are undisputed, and under these circumstances, we respectfully submit that not only did the District Court err in dismissing the complaint in the case at bar, but it should have granted plaintiff summary judgment.

On June 26, 1958, the Court of Appeals for the 8th Circuit in *Booth v. Barber Transportation Co.*, 27 Law Week 2003, held that summary judgment was proper in an equitable action when the facts were undisputed, saying:

“Summary judgments have been awarded in actions where the relief sought was equitable in nature. *Dale v. Preg*, 9 Cir., 204 F. 2d 434; *Huntington Palisades Property Owners Corp. v. Metropolitan Finance Corp.*, 9 Cir., 180 F. 2d 132; *Curtis v. O’Leary*, 8 Cir., 131 F. 2d 240.

“In the *Dale* case, *supra*, specific performance of a contract to sell land was granted by summary judgment. The court states (p. 435): ‘* * * The Court correctly disposed of the question as one of law. * * * There being no genuine dispute of fact on any mate-

rial issue, the court below did not err in entering summary judgment. * * *

“We find nothing in Rule 56 to support a conclusion that summary judgment is not available in actions which were formerly equitable actions. Rule 2 * * * provides, ‘There shall be one form of action to be known as “civil action”’ Paragraph 56.02(1), Moore’s Federal Practice, states, ‘Rule 56 makes the procedure available in all actions that are subject to the Rules, and, in accordance with the mandate of Rule 2, whether formerly legal or equitable.’ We are satisfied that Rule 56 authorizes a summary judgment in a proper case in an action formerly cognizable solely in equity.”

There are two conclusions set forth in the affidavit submitted by the defendant in opposition to the motion for summary judgment, which it claims should compel a denial of McNeil’s motion for summary judgment. The first is that the plaintiff was negligent in employing Lex Lamb without inquiry because he was a notorious criminal and a fugitive from justice. The second reason is that Seaboard Surety Company indemnified the plaintiff. This second reason has been adequately discussed above and there is no need to consider it further here.

Turning our attention to the admitted fact that plaintiff did not make any investigation into Lamb’s background before employing him, it should be remembered that Lamb was not employed in a confidential or executive position, but only in a relatively menial position. Secondly, there was no labor pool in Yellowstone National Park, and McNeil was compelled to rely upon transients to obtain laborers. These facts are undenied by the defendant.

The contention of defendant at bar was also made by the defendant in *Basch v. Bank of America*, 139 Pac. (2d) 1, 22 Cal. (2d) 316, where the defendant claimed that the plaintiff was negligent "in entrusting the management of his banking affairs to Lahr without having made any inquiry at the time of the latter's employment as to his reputation for honesty and integrity." The court rejected this contention. Moreover, the defendant also raised as a defense the negligent conduct of the plaintiff in failing to examine his bank statements for a period of ten months and thus discovering the forgeries. The court nevertheless held that the plaintiff was entitled to recover from the bank, stating (p. 9):

"Under the authorities above cited, as well as others, the remiss conduct of the depositor in such cases as this is available as a defense to the bank *only* where it appears that the bank itself is free from negligence in the first instance in the payment of the forged checks. If in the exercise of due care the bank would have detected the forgeries without the aid of the depositor, the bank cannot then escape its contractual liability merely because the depositor was also at fault. In such circumstances, the bank does not pay because previous forgeries were not reported to it, *but it pays because on its own negligent inspection it supposed the checks were genuine*. Moreover, in line with the rigor of the rule that a bank pays out the money of its depositors on forged instruments at its peril, it was held in *Sommer v. Bank of Italy*, 109 Cal. App. 370, 376, 293 Pac. 98; that a bank seeking to escape liability for cashing unauthorized checks drawn against its depositor's account has the burden of proving as a preliminary point its own freedom from negligence in the matter." (Emphasis supplied)

In addition to the foregoing, assuming that McNeil

had a duty to defendant under the circumstances presented here to make inquiry concerning the honesty of any laborer that it might employ, nevertheless that negligent conduct, if it was such, was not a proximate cause of the loss under consideration. A proximate cause of the loss under elementary rules of causation was the negligent conduct of the bank in failing to inspect, properly, these twenty-nine payroll checks. Even the most casual inspection of them would have revealed that something was wrong. As a depositor, McNeil necessarily had placed with the bank the signatures of those agents of McNeil authorized to draw checks on its account. No claim is made in the opposing affidavit submitted by the defendant under oath that these were excellent copies of authorized signatures, but even assuming that they were excellent copies of authorized signatures, the bank certainly should have been put on notice when on October 2, 1956, the bank received three identical checks, each payable to Lex Lamb, each in the sum of \$143.04, each dated September 25, 1956, except one which was dated September 26, 1956, and each of which recited on their face that they were for the pay period of "9-26-56", and each of which was stamped paid by the bank on "10-2-56". It would seem apparent in view of the foregoing assuming for the sake of argument that it was negligent, that it was intervening misconduct of the defendant that was the proximate cause of the loss. Causation in Montana as well as in almost every other jurisdiction in the United States is defined as follows:

"The proximate cause of an injury is that which, in a natural and continuous sequence, unbroken by any new independent cause, produces the injury, and without which the injury would not have occurred."

Mize v. Rocky Mountain Bell Telephone Company,
38 Mont. 521,
100 Pac. 971.

In *Maynard v. City of Helena*, 160 Pac. (2d) 484, 117 Mont. 402, the court held that negligence cannot be predicated upon the failure to perform a statutory duty unless the failure to perform the duty imposed and required by statute is an efficient or proximate cause of which complaint is made.

We do not believe that there is any duty on the part of McNeil to investigate the background of a laborer it might employ in Yellowstone National Park, but even assuming that there was such a duty, it can hardly be argued that failure to perform his duty was an efficient or proximate cause of the payment of these twenty-nine payroll checks in a period of ten days by the Livingston State Bank.

Under these circumstances we respectfully submit that the plaintiff's motion for summary judgment should have been granted.

Respectfully Submitted

BROWN, SANDE, SYMMES &
FORBES

By WEYMOUTH D. SYMMES

United States Court of Appeals

For the Ninth Circuit

McNEIL CONSTRUCTION COMPANY,
a corporation,

Appellant,

v.

THE LIVINGSTON STATE BANK,
a corporation,

Appellee.

Appellant's Reply Brief

Appeal from the United States District Court for the
District of Montana.

BROWN, SANDE, SYMMES & FORBES
Attorneys at Law
Suite 200, First National Bank Bldg.
Billings, Montana

WEYMOUTH D. SYMMES, of Counsel
Attorneys for Appellant.

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Attorneys for Appellant.

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In this Reply Brief we shall consider the arguments of the appellee in the same order as discussed in the Appellee's Brief.

I.

Beginning on page 4 of Appellee's Brief, the argument is made that this Court cannot review the decision of Judge Murray granting defendant a conditional summary judgment because by amending plaintiff has "voluntarily" acquiesced in that order.

The answer to this position is twofold. First, by filing an amended complaint, we did not acquiesce in the Court's ruling denying the plaintiff's application for summary judgment. Therefore, this Court has full power to review that portion of Judge Murray's decision which denied plaintiff's application for summary judgment on undisputed facts. Second, as the authorities cited by the defendant show, the acquiescence must be voluntary before the rule is invoked, and each case must be decided on its own facts. A review of the facts confronting this Court on this question will, we submit, convince this Court that the acquiescence was involuntary in the case at bar.

At the time the motion was first argued before Judge Murray, Judge Jameson had theretofore denied the defendant's motion to dismiss the complaint on the ground that it did not state a claim for which relief can be granted. Despite this fact, Judge Murray granted the defendant a conditional summary judgment on the ground that the complaint did not state a claim for which relief could be granted, even though the missing elements, which Judge Murray thought should be pleaded, appeared in affidavits submitted in support of plaintiff's motion for summary judgment. Judge Murray recognized the fact that Judge Jameson's decision had precluded him from dismissing the complaint on the ground that it did not state facts for which relief could be granted, so in the alternative he granted the defendant a conditional summary judgment, which, as pointed out in our

first brief, is not authorized by any rule of civil procedure or by any case that we have been able to find. The effect, however, of the order granting defendant conditional summary judgment, as pointed out in our principal brief, was to decide the case on the merits and thus preclude not only McNeil from again filing suit, but also the Seaboard Surety Company. *Celanese Corporation v. John Clark Industries*, 214 Fed. 2d 551 (C. A. 5th 1954). Not only that, but summary judgment was granted to the defendant even though no such application had been made by the defendant.

Under these circumstances, plaintiff could not risk the entry of a judgment and thus test the validity of the Court's conclusion that the loan made by Seaboard to McNeil was in fact payment. Under these circumstances, it could hardly be argued that plaintiff's amended complaint constituted voluntary acquiescence in the Court's ruling. For that reason we respectfully submit that the first argument advanced by the appellee is without substance either in law or in fact. In any event, it does not preclude reviewing the denial of plaintiff's motion for summary judgment.

II.

The second argument advanced by the appellee is that this Court should defer to the trial judge's interpretation of Montana law. Recently this Court considered this argument in *Bower v. Bower*, 255 Fed. 2d 618 (C. A. 9th 1958), when it said:

"This court is inclined to the belief that the Mon-

tana Supreme Court would hold here as the district court did. Moreover, this court before it overrules any district judge on a matter of his state law should have a conviction that the district court was clearly wrong."

We believe that the authorities cited by us in our primary brief compel the conclusion that the District Court was clearly wrong in the case at bar. Moreover, the Montana case of *Rae v. Cameron*, 114 Pac. 2d 1060, 112 Mont. 159, which is cited on page 20 of our brief, clearly indicates that probably the Montana Supreme Court would sustain the validity of loan receipts and would permit McNeil to maintain this suit in the case at bar.

III.

The remaining portion of the defendant's brief relates to problems which we feel have been adequately briefed in the primary brief heretofore submitted by us. We feel it would be unduly burdensome for us to again repeat the arguments we have made there. We refer the Court to our primary brief as an answer to the remaining problems discussed by the appellee in its brief.

One thing, however, should be mentioned. The loan made by Seaboard to McNeil was for the exact amount of the loss and did not include any interest to which McNeil was entitled. In McNeil's complaint it not only seeks to recover the amount of the loss, but also interest from November 1, 1956. Aside from the fact that both Seaboard and McNeil designated the transaction as a loan, the intent of the parties to consider it a loan is made

manifest by McNeil's application for interest from November 1, 1956. The appellee's attempt to limit the decision of the Supreme Court of the United States in *Luckenbach v. W. J. McCahan Sugar Refining Company*, 248 U. S. 139, does not take into account the further development of the doctrine of loan receipts by other courts since the decision in the Luckenbach case in 1918. As the cases hold, there are equitable and commercial reasons for developing this doctrine. For example, in the case at bar McNeil could have in its discretion looked solely to the Livingston State Bank and its bonding company for payment of the loss, which would have involved delay and conceivable hardship. By relying upon loan receipts, McNeil could immediately obtain the use of the amount of the loss and still proceed against the defendant to recover interest for the period of time it was deprived of the use of this money.

Under the circumstances presented here, we respectfully submit that not only should the decision of the District Court be reversed, but that plaintiff should be granted summary judgment on the undisputed facts.

Respectfully submitted,

BROWN, SANDE, SYMMES
& FORBES

By Weymouth D. Symmes, of Counsel

No. 16051 ✓

United States
Court of Appeals
for the Ninth Circuit

AMERICAN PROPERTIES, INC., and THE
ESTATE OF STANLEY S. SAYRES, de-
ceased, HAROLD L. SCOTT, and A. R.
MUNGER, Executors, and MADELEINE A.
SAYRES, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

Petition to Review a Decision of The Tax
Court of the United States

FILED

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PAUL P. O'DRIEN, CLERK

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

KENNETH P. SHORT,
1107 American Building,
Seattle 4, Washington,
Attorney for Petitioners.

CHARLES K. RICE,
Assistant U. S. Attorney General,
LEE A. JACKSON,
Attorney,
Tax Division,
Department of Justice,
Washington 25, D. C.,
Attorneys for Respondent.

Tax Court of the United States

Docket No. 57748

AMERICAN PROPERTIES, Inc., Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency bearing symbols Ap:S:AA:90D-TRB:MHB dated February 17, 1955, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation with its principal office at Seattle, Washington, its mailing address being Box 1893, Seattle 11, Washington. The returns for the years here involved were filed with the Collector of Internal Revenue for the District of Washington.

2. The notice of deficiency, a copy of which is attached hereto, marked Exhibit "A", was mailed to the petitioner on February 17, 1955.

3. The deficiencies as determined by the Commissioner are in income taxes for the calendar years 1949 and 1950 in the respective amounts of \$495.78 and \$3,601.31, a total of \$4,097.09 for both years. The entire amount of the deficiencies is in dispute.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

I. The respondent erred in disallowing for the

year 1949 the cost of taxes, maintenance, and operation of racing boats in the amount of \$2,155.56 as not being an ordinary and necessary business expense.

II. Respondent erred in not allowing as a deduction for the year 1949 a net operating loss carry-back from the year 1950 in the amount of \$1,561.41.

III. Respondent erred in not allowing as additional repair expense the amount of \$561.39 expended in 1949 and not claimed as a deduction on petitioner's original 1949 income tax returns.

IV. The respondent erred in disallowing for the year 1950 the cost of taxes, maintenance, and operation of racing boats in the amount of \$11,388.43 as not being an ordinary and necessary business expense.

V. The respondent erred in disallowing for the year 1950 depreciation on boats and related equipment in the amount of \$5,830.84 as not being assets used in the trade or business of petitioner and not held for production of income.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Petitioner was organized in 1931 under the laws of the State of Washington under the name of Williams Auto Company. Its name was later changed to American Properties, Inc. Article III of the original Articles of Incorporation sets forth the objects and purposes for which the corporation was formed and provides, among other things, "To buy, lease, deal in and deal with, store and repair automobiles and motor vehicles of all descriptions,

airplanes, motor boats and marine engines, bicycles, motoreycles, and all of their parts and accessories, and all articles and supplies used in connection therewith”.

(b) In 1949 petitioner decided to enter into the business of dealing in and dealing with motor boats and marine engines. Late in that year it purchased Slo-Mo-Shun III, Slo-Mo-Shun IV, and certain boat equipment for \$18,609.16.

(c) Petitioner expended the net amounts of \$2,155.56 and \$11,388.43 in the year 1949 and 1950, respectively, for taxes, maintenance and operating expenses of these boats. It claimed depreciation on the boats and equipment in 1950 as an ordinary and necessary business expense in the amount of \$5,830.84.

(d) Petitioner's original 1950 income tax return showed a loss from operations for that year in the amount of \$1,561.41. This amount should be allowed as a net operating loss deduction for the year 1949. On June 29, 1951 petitioner filed a claim for refund for the year 1949 in an attempt to recover the overpayment of 1949 taxes paid resulting from the carry-back of the 1950 net operating loss. Respondent has not allowed the refund.

(e) Repair expense in the amount of \$561.39 was expended in 1949 and erroneously charged to the American Automobile Company and not claimed as a deduction on petitioner's 1954 income tax return. On August 19, 1952 petitioner filed a claim for refund to recover the overpayment of 1949 income taxes resulting from the understatement of operat-

ing expenses for the year 1949 by the amount of \$561.39. Respondent has not allowed the refund.

Wherefore, petitioner prays that this Court may hear the proceeding and that the case be set for trial at Seattle, Washington; that it find that the respondent has erred in the respects and to the extent stated in paragraph 4, supra; that there is no deficiency in Federal income tax due from the petitioner for either one of the years 1949 or 1950; that petitioner is entitled to a refund of a portion of the taxes paid by it for the year 1949 and that this Honorable Court may enter its order accordingly, and/or give such other and further relief, as, in the judgment of this Court, may be fit and proper.

/s/ TRACY GRIFFIN,

/s/ HAROLD L. SCOTT,

Counsel for Petitioner.

Duly Verified.

EXHIBIT "A"

Form 1230 (App.)

123 United States Court House
Seattle 4, Washington

Ap:S:AA:90D

February 17, 1955

American Properties, Inc.

Box 1893, Seattle 11, Washington

Gentlemen:

You are advised that the determination of your

Exhibit "A"—(Continued)

income tax liability for the taxable year(s) ended December 31, 1949, and December 31, 1950, discloses a deficiency or deficiencies of \$4,097.09 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, 123 U. S. Court House, Seattle 4, Washington. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earlier.

Exhibit "A"—(Continued)

Very truly yours,

T. COLEMAN ANDREWS,

Commissioner, Internal Revenue,

/s/ By JAMES E. WESTIN,

Associate Chief, Appellate Division.

Enclosures: Statement, Form 1276, Agreement
Form.

STATEMENT

Ap:S:AA:90D

TRB:MHB

American Properties, Inc.

Box 1893

Seattle 11, Washington

Tax liability for taxable years ended December 31, 1949 and
December 31, 1950.

Year	Liability	Income Tax	
		Assessed	Deficiency
1949	\$2,333.13	\$1,837.35	\$ 495.78
1950	3,601.31	None	3,601.31
Totals	\$5,934.44	\$1,837.35	\$4,097.09

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated June 18, 1952; to your protest dated May 12, 1953; to the statements made at the conferences held on March 31 and August 30, 1954; and to your claims for refund filed on June 29, 1951, and August 19, 1952.

If a petition to The Tax Court of the United States is filed against the deficiency proposed herein, the issues set forth in your claims for refund should be made a part of the petition to be considered by The Tax Court in any redetermination of your tax liability. If a petition is not filed, the claims for refund will be disallowed and official notice will be issued by registered mail in accordance with section 3772 of the 1939 Internal Revenue Code.

Exhibit "A"—(Continued)

A copy of this letter and statement has been mailed to your representative, Mr. Harold L. Scott, Stuart Building, Seattle 1, Washington, in accordance with the authority contained in the power of attorney executed by you.

Taxable Year Ended December 31, 1949

Adjustments to Net Income

Net income disclosed by return, Form 1120	\$ 8,423.26
Unallowable deductions and additional income:	
(a) Boat expenses	2,155.56
	<hr/>
Net income adjusted	\$10,578.82

Explanation of Adjustments

(a) Included in deductions on the corporation's return was the cost of taxes, maintenance, and operation of racing boats in the total amount of \$2,155.56. It has been determined that such expenses were not ordinary and necessary business expenses and therefore not allowable as deductions. Net income is increased accordingly.

Computation of Tax

Net income adjusted	\$10,578.82
Normal tax and surtax net income	10,578.82
Normal tax:	
15 per cent of \$5,000.00	\$ 750.00
17 per cent of \$5,578.82	948.40
	<hr/>
Total normal tax	1,698.40
Surtax:	
6 per cent of \$10,578.82	634.73
	<hr/>
Income tax liability	\$ 2,333.13
Assessed:	
Orig. Acct. No. 6410036	1,837.35
	<hr/>
Deficiency	\$ 495.78

Exhibit "A"—(Continued)

Taxable Year Ended December 31, 1950

Adjustments to Net Income

Net income (loss) disclosed by return, Form 1120	\$ (1,561.41)	
Unallowable deductions and additional income:		
(a) Boat expenses	\$11,388.43	
(b) Boat depreciation	5,830.84	17,219.27
	<hr/>	<hr/>
Net income adjusted		\$15,657.86

Explanation of Adjustments

(a) Included in deduction on the corporation's return was the cost of taxes, maintenance, and operation of racing boats in the net amount of \$11,388.43. It has been determined that such expenses were not ordinary and necessary business expenses and therefore not allowable as deductions. Net income is increased accordingly.

(b) Included in deductions on the corporation's return was depreciation on boats and related equipment in the amount of \$5,830.84. It has been determined that those assets were not used in the trade or business of the corporation and were not held for the production of income. Depreciation on such assets is not allowable. Net income is therefore increased by the above \$5,830.84.

Computation of Tax

Net income adjusted	\$15,657.86
Combined normal tax and surtax:	
23 per cent of \$15,657.86	\$ 3,601.31
Income tax liability	\$ 3,601.31
Assessed:	
Orig. Acct. No. 9204706	None
	<hr/>
Deficiency	\$ 3,601.31

Served: May 11, 1955.

[Endorsed]: T.C.U.S. Filed May 11, 1955.

[Title of Tax Court and Docket No. 57748.]

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, and for answer to the petition filed herein, admits and denies as follows:

1. Admits that the petitioner is a corporation with its only office at Seattle, Washington, its mailing address being Box 1893, Seattle 11, Washington. Admits that the returns for the years here involved were filed with the Collector of Internal Revenue for the District of Washington.

2. Admits the allegations of paragraph 2 of the petition.

3. Admits the allegations of paragraph 3 of the petition.

4. I. to V. Denies the allegations of paragraphs 4. I. to V., inclusive, of the petition.

5. (a) and (b). Denies the allegations of paragraphs 5 (a) and (b) of the petition.

(c) Denies the allegations of paragraph 5 (c) of the petition except it is admitted that petitioner claimed depreciation on "the boats and equipment" in 1950 as an ordinary and necessary business expense in the amount of \$5,830.84.

(d) Denies the allegations of paragraph 5 (d) of the petition except it is admitted that petitioner's original 1950 income tax return showed a loss from operations for that year in the amount of \$1,561.41, and that on June 29, 1951 petitioner filed a claim

for refund for the year 1949, which claim for refund has not been allowed by the respondent.

5. (e) Denies the allegations of paragraph 5 (e) of the petition except it is admitted that on August 19, 1952 petitioner filed a claim for refund for the taxable year 1949 in the amount of \$129.11, which claim for refund has not been allowed by the respondent.

6. Denies generally each and every allegation of the petition not hereinabove specifically admitted, qualified or denied.

Wherefore, it is prayed that the relief sought in the petition be denied and that the deficiencies in income taxes for the taxable years 1949 and 1950, as set forth in the notice of deficiency, be in all respects approved.

/s/ JOHN POTTS BARNES, WHP,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
Gordon N. Cromwell, Special Attorney, Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed July 6, 1955.

Tax Court of the United States

Docket No. 57751

STANLEY S. SAYRES AND MADELEINE A.
SAYRES, husband and wife, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioners hereby petition for a redetermination of the deficiencies and penalty set forth by the Commissioner of Internal Revenue in his notice of deficiency bearing symbols Ap:S:AA:90D-TRB:MHB dated February 17, 1955, and as a basis of their proceeding allege as follows:

1. Petitioners are individuals residing in Bellevue, Washington, their mailing address being Route 1, Box 325, Bellevue, Washington. The returns for the periods here involved were filed with the Collector of Internal Revenue for the District of Washington.

2. The notice of deficiency, a copy of which is attached hereto, marked Exhibit "A", was mailed to the petitioners on February 17, 1955.

3. The taxes in controversy are for income taxes for the fiscal years ended October 31, 1949, and October 31, 1950, in the respective amounts of \$10,400.69 and \$12,830.51, a total of \$23,231.20 for

both years. The penalty in controversy has been asserted under Section 293(a) of the Internal Revenue Code (1939) for the fiscal year ended October 31, 1950 in the amount of \$641.53.

4. The determination of taxes and penalty set forth in said notice of deficiency is based upon the following errors:

I. The respondent erred in increasing petitioners' "other income" in the amount of \$16,401.51 for the year ended October 31, 1949. Respondent explains this adjustment as "It has been determined that you received taxable income of \$16,401.51 from American Properties, Inc., which you failed to report as income on your return. Net income is increased accordingly." Since the composition of the amount of \$16,401.51 has not been explained other than set forth above in respondent's statutory notice of deficiency, such arbitrary procedure compels petitioners to deny the same.

II. The respondent erred in increasing petitioners' "Other income" in the amount of \$16,595.31 for the year ended October 31, 1950. Respondent explains this adjustment as "It has been determined that you received taxable income in the total amount of \$16,595.31 from American Properties, Inc., which you failed to report as income on your return. Net income is increased accordingly." Since the composition of the amount of \$16,595.31 has not been explained other than set forth above in respondent's statutory notice of deficiency, such

arbitrary procedure compels petitioners to deny the same.

III. The respondent erred in increasing salary income by the amount of \$3,200.00 for the year ended October 31, 1950.

IV. The respondent erred in asserting the penalty provided for in Section 293(a) of the Internal Revenue Code (1939).

5. The facts upon which the petitioners rely as the basis of this proceeding are as follows:

(a) Petitioners did not receive taxable income in the amount of \$16,401.51 from American Properties, Inc. which they failed to report in the year ended October 31, 1949.

(b) Petitioners did not receive taxable income in the amount of \$16,595.31 from American Properties, Inc. which they failed to report in the year ended October 31, 1950.

(c) In December 1949, Jen-Cel-Lite Corporation authorized petitioner, Stanley S. Sayres, a salary of \$800.00 per month, effective July 1, 1949. Since \$3,200.00 of this salary was paid for services rendered during the months of July, August, September and October, 1949, this amount should not be included in petitioners' income for the year ended October 31, 1950.

Wherefore, petitioners pray that this Court may hear the proceeding and that the case be set for trial at Seattle, Washington; that it find that respondent has erred in the respects and to the extent

stated in paragraph 4 supra; and that this Honorable Court may enter its order accordingly, and/or give such other and further relief as, in the judgment of this Court, may be fit and proper.

/s/ TRACY GRIFFIN,

/s/ HAROLD L. SCOTT,

Counsel for Petitioners.

Duly Verified.

EXHIBIT "A"

Form 1231 (App.)

U. S. Treasury Department
Internal Revenue Service, Regional Commissioner,
123 United States Court House, Seattle 4,
Washington.

In Replying Refer to

Feb. 17, 1955

Ap:S:AA:90D-TRB:MHB

Mr. Stanley S. Sayres and Mrs. Madeleine

A. Sayres

Husband and Wife

Route 1, Box 325

Bellevue, Washington

Dear Mr. and Mrs. Sayres:

You are advised that the determination of your income tax liability for the taxable years ended October 31, 1949 and October 31, 1950 discloses deficiencies in tax aggregating \$23,231.20 and a penalty of \$641.53 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Exhibit "A"—(Continued)

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, 123 U. S. Court House, Seattle 4, Washington. The signing and filing of this form will expedite the closing of your case by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earlier.

Very truly yours,

T. COLEMAN ANDREWS,

Commissioner, Internal Revenue,

By

Associate Chief, Appellate Division.

Enclosures: Statement, Form 1276, Agreement
Form.

Exhibit "A"—(Continued)

STATEMENT

Ap:S:AA:90D—TRB:MHB

Mr. Stanley S. Sayres and Mrs. Madeleine A. Sayres
 Husband and Wife
 Route 1, Box 325
 Bellevue, Washington

Tax liability for the taxable years ended October 31, 1949
 and October 31, 1950.

Year	Income Tax	Sec. 293(a)
	Deficiency	Penalty
October 31, 1949	\$10,400.69	None
October 31, 1950	12,830.51	\$641.53
Total	\$23,231.20	\$641.53

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated June 18, 1952; to your protest dated December 18, 1952; and to the statements made at the conferences held on March 31 and August 30, 1954.

It has been determined that you are liable for a penalty of \$641.53 under the provisions of section 293(a) of the 1939 Internal Revenue Code for the taxable year ended October 31, 1950.

A copy of this letter and statement has been mailed to your representative, Mr. Harold L. Scott, Stuart Building, Seattle 1, Washington, in accordance with the authority contained in the power of attorney executed by you.

Taxable Year Ended October 31, 1949

Adjustments to Net Income

Net income disclosed by return, Form 1040	\$42,782.07
Unallowable deductions and additional income:	
(a) Depreciation	\$ 246.59
(b) Other income	16,401.51
(c) Contributions	100.00
(d) Interest	1,553.75
(e) Taxes	1,434.62
Net income adjusted	\$62,518.54

Exhibit "A"—(Continued)

Explanation of Adjustments

(a) 1. It has been determined that the depreciation claimed on East Union Street building improvements is excessive in the amount of \$267.90.

2. It has been determined that the depreciation of improvements on Hunts Point property is \$500.94 instead of \$479.63, or \$21.31 more than that claimed in your return.

1. Depreciation of East Union Street building improvements overstated	\$267.90
2. Depreciation of Hunts Point property improvements understated	21.31

Net additional income \$246.59

(b) It has been determined that you received taxable income of \$16,401.51 from American Properties, Inc., which you failed to report as income on your return. Net income is increased accordingly.

(c) The amount of \$100.00, claimed as a deduction in your return for contributions paid to Detroit International Regatta Association is held not deductible under the provisions of Section 23(o) of the 1939 Internal Revenue Code. Your taxable net income is therefore increased by such amount.

(d) It has been determined that interest of \$1,553.75 paid on a loan to purchase a single premium life insurance contract and claimed as a deduction in your return is not deductible. Your taxable net income is therefore increased by such amount.

(e) It has been determined that you overstated the deduction for taxes paid in the net amount of \$1,434.62, computed as follows:

1. Included in the deduction for State and city business, sales, and excise taxes is the amount of \$4,189.04 claimed as miscellaneous taxes appertaining to construction work performed under contract on your residential properties. Since such taxes are levied against the contractor, they are not an allowable deduction in computing your taxable net income.

2. Washington State sales taxes in the total amount of \$3,743.92 paid by you on the construction work performed is allowed as a deduction in computing your taxable net income.

3. The amount of \$1,412.28, represented in your return as payroll taxes, has been determined to be Social Security taxes and contributions imposed on the contractor and therefore un-

Exhibit "A"—(Continued)

allowable as a deduction in computing your taxable net income.

4. You are allowed a deduction of \$422.78 for Washington State sales taxes paid for your benefit by American Properties, Inc.

Summary of adjustments:

1. Unallowable State and city business, sales and excise taxes:		
Brewster house	\$	563.31
New house		3,625.73
Total	\$	4,189.04
2. Allowable State sales taxes on construction work:		
Brewster house	\$	510.40
New house	3,233.52	(3,743.92)
3. Unallowable payroll taxes		1,412.28
4. State sales taxes paid by American Properties, Inc.	(422.78)
Net additional income	\$	1,434.62

Computation of Alternative Tax

Net income adjusted	\$62,518.54
Less: Exemptions	1,200.00
Balance	\$61,318.54
One-half of balance	\$30,659.27
Minus: One-half of net long-term capital gain	314.25
Income subject to tentative tax	\$30,345.02
Tentative tax	\$13,433.91
Less: \$68.00 plus 12 per cent of \$13,033.91	1,632.07
Balance	\$11,801.84
Combined partial normal tax and surtax— \$11,801.84 times 2	\$23,603.68
Add: one-half of net long-term capital gain	314.25
Income tax liability	\$23,917.93
Liability disclosed by return:	
Original Acct. No. 2319301	13,517.24
Deficiency	\$10,400.69

Exhibit "A"—(Continued)

Taxable Year Ended October 31, 1950

Adjustments to Net Income

Net income disclosed by return, Form 1040		\$59,901.25
Unallowable deductions and additional income:		
(a) Salary	\$ 3,200.00	
(b) Depreciation	156.52	
(c) Other income	16,595.31	
(d) Capital gain	1,493.00	
(e) Interest	1,553.75	22,998.58
<hr/>		<hr/>
Total		\$82,899.83
(f) Dividends	\$ 50.00	
(g) Taxes	292.37	342.37
<hr/>		<hr/>
Net income adjusted		\$82,557.46

Explanation of Adjustments

(a) It has been determined that you received a salary of \$12,800.00 from the Jen-Cel-Lite Corporation whereas you reported income of \$9,600.00 from that source on your return. Accordingly, net income is increased by \$3,200.00, the difference between the above two amounts.

(b) 1. It has been determined that the depreciation claimed on East Union Street building improvements is excessive in the amount of \$267.90.

2. It has been determined that the depreciation of improvements on Hunts Point property is \$1,502.81 instead of \$1,391.43, or \$111.38 more than that claimed in your return.

1. Depreciation of East Union Street building improvements overstated	\$267.90
2. Depreciation of Hunts Point property improvements understated	111.38
<hr/>	

Net additional income \$156.52

(c) It has been determined that you received taxable income in the total amount of \$16,595.31 from American Properties, Inc., which you failed to report as income on your return. Net income is increased accordingly.

(d) On your return you reported taxable long-term capital gain in the amount of \$3,638.00 on the sale of residential prop-

Exhibit "A"—(Continued)

erty at 3140 E. Laurelhurst Drive, Seattle. It has been determined that your correct income from that source was \$5,131.00. Accordingly, net income is increased by \$1,493.00, the difference between the above two amounts.

(e) It has been determined that interest in the amount of \$1,553.75 paid on a loan to purchase a single premium life insurance contract and claimed as a deduction in your return is not an allowable deduction. Your taxable net income is therefore increased by such amount.

(f) It has been determined that you received taxable dividends from Willys-Overland Company in the amount of \$450.00. Since you reported dividend income of \$500.00 from this source, your taxable net income is reduced \$50.00.

(g) You are allowed a deduction of \$292.37 for taxes paid for your benefit by American Properties, Inc. as follows:

Washington State sales tax paid in period	
11/1/49 to 12/31/49	\$ 81.17
Washington State sales tax paid in period	
1/1/50 to 10/31/50	185.20
Trailer license paid in period 1/1/50 to 10/31/50	26.00
	<hr/>
Total	\$292.37

Computation of Alternative Tax

Net income adjusted	\$82,557.46
Less: Exemptions	1,200.00
	<hr/>
Balance	81,357.46
One-half of balance	\$40,678.73
Minus: One-half of net long-term capital gain	1,990.59
	<hr/>
Income subject to tax	\$38,688.14
Tentative tax computed at rates in effect prior to 10/1/50:	
Combined normal tax and surtax on \$38,688.14	\$18,834.82
Less: \$68.00 plus 12 per cent of \$18,434.82	2,280.18
	<hr/>
Balance	\$16,554.64
Total tentative tax computed at rates in effect prior to 10/1/50—\$16,554.64 times 2	\$33,109.28

Exhibit "A"—(Continued)

Tentative tax computed at rates in effect after 9/30/50:	
Combined normal tax and surtax on \$38,683.14	\$18,834.82
Total tentative tax computed at rates in effect	
after 9/30/50—\$18,834.82 times 2	\$37,669.64
Portion of tentative tax computed at rates prior	
to 10/1/50 applicable:	
11/12 of \$33,109.28	\$30,350.17
Portion of tentative tax computed at rates after	
9/30/50 applicable:	
1/12 of \$37,669.64	3,139.14
<hr/>	
Partial tax	\$33,489.31
Add: One-half of net long-term capital gain	1,990.59
<hr/>	
Income tax liability	\$35,479.90
Liability disclosed by return:	
Orig. acct. No. 9129504	22,649.39
<hr/>	
Deficiency	\$12,830.51

Served: May 11, 1955.

[Endorsed]: T.C.U.S. Filed May 11, 1955.

[Title of Tax Court and Docket No. 57751.]

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, and for answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations of paragraph 1 of the petition.

2. Admits the allegations of paragraph 2 of the petition.

3. Admits the allegations of paragraph 3 of the petition.

4. I. to IV. Denies the allegations of paragraphs 4. I. to IV., inclusive, of the petition.

5. (a) to (c). Denies the allegations of paragraphs 5 (a) to (c), inclusive, of the petition.

6. Denies generally each and every allegation of the petition not hereinabove specifically admitted, qualified or denied.

Wherefore, it is prayed that the relief sought in the petition be denied and that the deficiencies in income taxes and penalties for the taxable years ended October 31, 1949 and 1950, as set forth in the notice of deficiency, be in all respects approved.

/s/ JOHN POTTS BARNES, WHP,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
Gordon N. Cromwell, Special Attorney, Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed July 6, 1955.

28 T. C. No. 127

Tax Court of the United States

AMERICAN PROPERTIES, INC., ET AL.,¹
Petitioners,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket Nos. 57748, 57749, 57750, 57751. Filed
August 30, 1957.

FINDINGS OF FACT AND OPINION

Held, that the activities of the corporate petitioner in constructing, maintaining, and operating racing boats did not constitute the carrying on of a trade or business, but were incident to the personal hobby of its sole stockholder, and the corporation is not entitled to deduct amounts expended by it as ordinary and necessary business expenses, or to take deductions for depreciation on the boats. Held, further, that the amounts expended by the corporation are properly taxable to the individual petitioners, since such expenditures were solely for the personal benefit of the individual petitioner who was the sole stockholder. Held, further, that the indi-

¹ Proceedings of the following petitioners are consolidated herewith: American Properties, Inc., Docket No. 57748; Stanley S. Sayres, Docket No. 57749; Madeleine A. Sayres, Docket No. 57750; and Stanley S. Sayres and Madeleine A. Sayres, Docket No. 57751.

vidual petitioners omitted certain salary income from their returns, and that the respondent properly determined additions to tax on account thereof, pursuant to section 293(a), Internal Revenue Code of 1939.

Tracy Griffin, Esq. and Kenneth P. Short, Esq., for the petitioners.

Gordon N. Cromwell, Esq., for the respondent.

Atkins, Judge:

The respondent determined deficiencies in income tax and additions to the tax as follows:

Petitioner	Year Ending	Deficiency	Addition §293(a)
Stanley S. Sayres	Oct. 31, 1948	\$ 1,937.39	\$ 96.87
Madeleine A. Sayres	Oct. 31, 1948	1,906.23	95.31
Stanley S. and Madeleine A. Sayres	Oct. 31, 1949	10,400.69	None
Stanley S. and Madeleine A. Sayres	Oct. 31, 1950	12,830.51	641.53
American Properties, Inc.	Dec. 31, 1949	495.78	None
American Properties, Inc.	Dec. 31, 1950	3,601.31	None

American Properties, Inc. claims that there has been an overpayment in its tax for the year 1949.

The principal issue is whether certain expenditures made by the petitioner American Properties, Inc., in 1949 and 1950 in connection with designing, constructing, and racing of speed boats constituted deductible business expenses of the corporation, or whether such expenditures constituted personal hobby expenses paid by the corporation on behalf of its stockholder, the petitioner Stanley S. Sayres, taxable to him and his wife, the petitioner Made-

leine A. Sayres, and nondeductible by the corporation.

A second issue relating to the individual petitioners for the years 1948 and 1950 concerns omissions of salary income of the petitioner Stanley S. Sayres and additions to the tax for negligence relating to omissions of salary income.

Findings of Fact

The petitioners, Stanley S. Sayres and Madeleine A. Sayres, are husband and wife, and the petitioner American Properties, Inc., is Stanley S. Sayres' wholly-owned corporation. The individual petitioners reported their income on a fiscal year basis ending October 31. The corporation keeps its books and reports its income on a calendar year basis. The individuals filed separate income tax returns for the taxable year 1948 and filed joint returns for the taxable years 1949 and 1950. These returns and the returns of the corporation for the years 1949 and 1950 were filed with the collector of internal revenue at Tacoma, Washington. The petitioner Stanley S. Sayres is referred to hereinafter as the petitioner, or as Sayres, and the petitioner American Properties, Inc. is sometimes referred to hereinafter by name or as the corporation.

Prior to 1931 the petitioner was engaged in the automobile business in Pendleton, Oregon. In that year he went to Seattle and purchased Williams Auto Company, a corporation, the name of which he changed to American Properties, Inc. (one of the petitioners herein). During the years in ques-

tion he owned all the stock of the corporation except a qualifying share, which was held by his attorney. The petitioner also purchased stock of American Automobile Company. During the years in question he was also the principal stockholder of that corporation. That company operated an automobile dealership and was a tenant of premises owned by American Properties, Inc.

The petitioner has always enjoyed speed and it had been his desire to drive a boat faster than anyone had ever done before. Prior to going to Seattle he had engaged in outboard motor boat racing.

After moving to Seattle the petitioner for several years did not engage in boat racing. However, at some time prior to 1948 he purchased a used racing boat which had previously attained a speed of 80 m.p.h., and he named it Slo-Mo-Shun. Thereafter he built successively Slo-Mo-Shun II and Slo-Mo-Shun III. In the design, construction, operation, and maintenance of Slo-Mo-Shun III, the petitioner retained technical assistance of experts who were recognized as outstanding in their fields. Since Ted Jones, the boat designer, was employed on a full time basis as an engineer with an airplane company, his work for the petitioner was done at nights, on week ends, and on holidays. Anchor Jensen, of the local boat building firm, Jensen Motor Boat Company, was the builder. The petitioner, Jones and Jensen watched the 1948 Gold Cup races in Detroit in August 1948, and after their experience with the first Slo-Mo-Shun and Slo-Mo-Shun II and III they recognized the tremendous room

for improvement in the designing of racing boats. At that time they also recognized the possibility of profit to be made in the designing, construction and sale of racing boats. They considered the possibility that the Navy might become interested in the basic design of these fast boats and might become an important customer. Jones proceeded to design Slo-Mo-Shun IV which would be revolutionary in the field of unlimited hydroplane boats. He used the identical design which he had used for years in building and racing limited class boats. By August 1949, Jones and the petitioner concluded that Slo-Mo-Shun IV, which was then in the process of construction, would prove to be far superior to boats currently being used.

The petitioner had consulted his attorney, his accountant, and his financial adviser, an official of the Seattle-First National Bank, who all agreed on the profit possibility in the designing, building, and sale of boats. The banker advised against the petitioner's undertaking any such business enterprise in an individual capacity. In discussions with the attorney the petitioner suggested that inasmuch as the articles of incorporation of American Properties, Inc. already contained provisions which would authorize the construction and sale of boats and marine supplies or engines, such corporation might undertake the venture without the necessity of creating a new corporation.

The minutes of a meeting of the directors of the corporation held on August 31, 1949, contain the following:

Preliminary discussions had been had with reference to this corporation entering the field of boat building, ownership and management. Counsel reported that the Articles of Incorporation were sufficiently broad to warrant entry upon such a program.

Mr. Sayres in connection with the Country wide interest in power boat racing suggested that "Slo-Mo-Shun III" was in his opinion far superior to the major racing boats; that an improvement in design had been perfected and in his opinion "Slo-Mo-Shun III" was by no means the last word in the field. In other words, there would be continuous improvement and if sufficient time was devoted to experimental and engineering work other boats would become obsolete and the Seattle boat would be the pattern all over the Country.

He suggested that he believed if the Company would enter the field, do the necessary experimental and engineering work that not only was there money to be made in the manufacture and sale of racing crafts, but in the commercial field as well. That he believed the Government would itself be interested in the fastest type of boat that could be manufactured.

It was recognized that there would be substantial experimental cost to lay the groundwork for future development.

He further stated that he was willing to transfer title of Slo-Mo-Shun III to the corporation if the corporation would continue in an endeavor to work out improvements in design and engineering. He

particularly suggested that a new improved Slo-Mo-Shun should be designed and built for actual racing use.

Mr. Sayres also advised that he had substantial offers for Slo-Mo-Shun III and had no doubt of the salability of Slo-Mo-Shun the IVth and boats of that design and class.

It was agreed that it was to the best interest of the corporation to enter this new field and proceed with the construction of a new boat upon the improved design of Slo-Mo-Shun III, all with the end in view of when the time was propitious getting into commercial operation.

Mr. Sayres was authorized to proceed accordingly.

At this time Slo-Mo-Shun IV was in the process of being built. It was launched in October 1949.

At some time before October 31, 1949, the corporation paid to the petitioner an amount of \$14,690.30, which was the amount that had been expended by the petitioner in the construction of Slo-Mo-Shun III and of partial construction of Slo-Mo-Shun IV.

In 1949 there was no registration or licensing requirements with regard to boats of this character. The petitioner did not enter into any formal document transferring title of either Slo-Mo-Shun III or Slo-Mo-Shun IV to the corporation. There was no patent on the design of these boats.

The petitioner filled out forms with the county assessor of King County, Washington, for personal

property tax purposes, as of January 1, 1950 and 1951, indicating that he was the owner of Slo-Mo-Shun IV. The petitioner left blank the part of such forms calling for information as to whether he had transferred title. He belonged to the Seattle Yacht Club and has always been registered with the American Power Boat Association as the owner of Slo-Mo-Shun IV and V. The rules of that association provided, among other things, that each boat entered for a sanctioned race must be the bona fide property of the person in whose name she is entered, who must be a racing member of the association and a member of a club belonging to the association; that corporations or business concerns may not enter sanctioned races (although they may be members of the association) and may only enter a boat as the bona fide property of a club member who is also a racing member of the association, either by ownership or by charter.

On June 26, 1950, Slo-Mo-Shun IV, driven by the petitioner on Lake Washington, established a new world straightaway speed record of 160 m.p.h., breaking the 11 year old record of 141 m.p.h. Recognizing the capabilities of this boat and the possibility of still further improvements of design in a model to be built, the petitioner sought a contractual arrangement which would include Ted Jones, the designer, and Anchor Jensen, the builder. However, because of disagreement as to technical engineering principles Jones refused to sign an agreement which would include Jensen as a party. On July 17, 1950, an agreement was executed "by and

between American Properties, Inc., (and/or S. S. Sayres) Party of the First Part, and Ted O. Jones, Party of the Second Part," which provided that whereas the first party had financed construction of Slo-Mo-Shun III and Slo-Mo-Shun IV and whereas second party designed both of those boats and assisted in development, construction, and testing, the parties agreed as follows: The second party agreed to work exclusively for the first party in the design and development of "Gold Cup" and "Unlimited" classes of racing boats during the existence of the contract and a period of one year thereafter; second party agreed not to disclose to others any basic or essential features of design, construction, or development; first party agreed that when constructing racing boats only second party would be employed to design such boats and to supervise construction, and that upon all boats sold by first party, in whom title should always rest, second party would receive a fee of \$5,000 or 10 percent of sale price, whichever was greater, this being in addition to time and material charges such as had been paid in the past; first party agreed that if Slo-Mo-Shun IV should be sold for an amount greater than cost, first party would pay second party 10 percent of actual net profit after taxes, or a flat sum of \$5,000 whichever was greater, in which case second party would, in consideration thereof, design a new "Unlimited" class racing boat for first party at no additional fee; both parties agreed that in event of any sale of plans and designs of "Gold Cup" and "Unlimited" boats, first

party would pay second party a fee of \$2,500 together with traveling expenses and a fee of \$25 per day actually spent in supervising construction. It was provided that the agreement should continue until terminated by written notice of either party, giving 180 days' notice. It was signed by S. S. Sayres as president of American Properties, Inc., and in his individual capacity, and by Jones.

On July 22, 1950, Slo-Mo-Shun IV, driven by Ted Jones, won the Gold Cup race. Following that Jones was approached by others seeking boats of the design of Slo-Mo-Shun IV. Horace Dodge sought to have two boats built, offering \$50,000 per boat. Jones sought approval of the petitioner which was refused.

Slo-Mo-Shun IV, driven by Lou Fageol, won the Harmsworth Trophy on August 2, 1950.

In August 1950, the Seattle-First National Bank loaned American Properties, Inc. \$26,000 to be used in operations in connection with the boats. No collateral was given for the loan.

In February 1951 construction of Slo-Mo-Shun V was commenced for the purpose of entering the 1951 Gold Cup races. The petitioner prevailed upon Jones and Jensen to work together in the construction of the boat. The boat was constructed at the premises of the Jensen Motor Boat Company under the supervision of Jones and with the aid of some of Jensen's boat builders. The boat was completed by the end of July 1951. Jones received \$5,000 for designing Slo-Mo-Shun V in addition to compen-

sation received on an hourly basis for its construction.

Lou Fageol, a wealthy sportsman who was one of the top two or three drivers in the country, drove Slo-Mo-Shun V and won the Gold Cup in 1951.

In 1952 Slo-Mo-Shun IV, driven by Stanley Dollar, a wealthy man of the Stanley Dollar Steamship lines, won the Gold Cup race. Joe Taggart, who has had as much racing experience as Fageol, also drove the Slo-Mo-Shun boats in competition. In 1953 and 1954 either Slo-Mo-Shun IV or Slo-Mo-Shun V won the Gold Cup races. The Slo-Mo-Shun boats have also won the Martini-Rossi Trophy for the fastest heat in a Gold Cup race and the Aaron DeRoy Plaque for the fastest over-all race average. The petitioner's name appears on the Gold Cup as the winner and the various trophies which were won by Slo-Mo-Shun boats were kept at the Seattle Yacht Club. There were no cash prizes in racing these boats.

The petitioner did not himself personally drive any of the boats in closed course competitive races, such as the Gold Cup or the Harmsworth races. He did drive in speed competition, as in 1950 when he broke the world's straightaway speed record.

About November 1, 1951, Ted Jones left Seattle and went east to work as a boat designer for another concern. He thus ceased to operate under the agreement of 1950. No formal notice of termination of the contract was ever given by either party. Because he felt restrained by the contract of 1950, Jones did not, for a number of years, build any

boats for others of the design of the Slo-Mo-Shun boats, although he had many opportunities to do so. However, commencing in January 1954, he did design a number of boats for various individuals throughout the country, employing the design of the Slo-Mo-Shun boats. At the time of the hearing in this case in 1956, there were about 20 boats eligible for competition in the unlimited class, of which all but four were of the basic Slo-Mo-Shun design.

The members of the crew of these boats included highly skilled technicians who worked on the various Slo-Mo-Shun boats in their spare time since they were full time employees of other organizations. None of them was employed by either American Properties, Inc. or American Automobile Company. Jones was compensated for designing the boats and Jensen was paid for his work in building them.

The principal construction work took place at the Jensen Motor Boat Company, but the engine work was done at the premises of American Properties, Inc., then under lease to American Automobile Company, where there was a machine shop for assembling engines. The small hand tools which were used were the properties of American Properties, Inc. Only occasionally was equipment of American Automobile Company used. An electric hoist which was used was not the property of American Automobile Company. Engines and parts were stored at these premises.

All costs of completing and operating Slo-Mo-

Shun IV and the costs of building and operating Slo-Mo-Shun V were borne by the corporation, including the expenses incurred in racing them, such as traveling expenses of the crew to Detroit in 1950.

The building owned by the American Properties, Inc. was located about one and one-half to two miles from the nearest navigable body of water. Slo-Mo-Shun III was moored at a dock at the petitioner's residence on Lake Washington. Later the petitioner constructed another residence on Lake Washington to which he moved in December 1950, and the Slo-Mo-Shun boats were then housed in the boat house at such residence. At times the boats were housed at the Jensen Motor Boat Company, which is on Lake Washington about five miles from the petitioner's new residence.

Greater Seattle, Inc., a nonprofit, publicly subscribed corporation which promoted the annual Seafair and other sporting events, sponsored campaigns to raise money for the operation of the Slo-Mo-Shun boats because of the advantage to Seattle of bringing the Gold Cup race to Seattle. In 1950 the amount contributed by Greater Seattle, Inc. for this purpose was \$6,912.15. This contribution, whether paid to the petitioner in the first instance, or to the corporation, was ultimately received by the corporation to defray part of the expense of operating Slo-Mo-Shun IV. In subsequent years other contributions were also received from Greater Seattle, Inc. through campaigns for public subscription. In sponsoring campaigns for raising money for this purpose, Greater Seattle, Inc. held

the petitioner out as the owner of the boats. Newspaper articles also consistently referred to the petitioner as the owner of the boats. The official programs of the Gold Cup races listed him as the owner.

The petitioner has never sold any of the Slo-Mo-Shun boats or any designs therefor. After Slo-Mo-Shun IV had been constructed some civilian representatives of the Navy Department examined it and observed it in action. There was no subsequent indication that the Navy would be interested.

In its income tax returns for the calendar years 1949 and 1950 the corporation showed its principal business activity as "Real Estate" and "Lessor of Building," respectively. It reported net income of \$8,423.26 in 1949 and a net loss of \$1,561.41 in 1950. Its returns show that it had surplus at December 31, 1949, of \$74,659.49 (of which \$37,497.43 was earned surplus) and at December 31, 1950, surplus of \$71,260.73 (of which \$34,098.67 was earned surplus).

In the calendar year 1949 the corporation expended \$2,155.56 in operation and maintenance of the boats, which it deducted on its corporate tax return as business expenses. The respondent disallowed this amount to the corporation. In addition, the corporation expended \$561.39 as additional boat expense which it did not deduct on the corporate return.

For the calendar year 1950 the corporation expended \$19,300.58 for operation and maintenance of the boats and deducted on its return the amount of

\$12,388.43 (after offsetting the contribution from Greater Seattle, Inc., in the amount of \$6,912.15). In the return there was included \$1,000 as income from endorsement of an oil product. In this situation the respondent considered that there had been claimed a net deduction of \$11,388.43, which he disallowed.

The corporation capitalized on its books and its returns for 1949 and 1950 the amounts expended for construction of the boats and related equipment (including the amount of \$14,690.30 which was paid by the corporation to the petitioner as hereinabove stated). In the 1949 return the balance sheet at the end of the year includes in depreciable capital assets the amount of \$18,609.16 for boats and equipment, but no depreciation was claimed. For 1950 the amount of capitalization of boats and equipment at year end was \$22,323.37 upon which depreciation was allowed in the amount of \$5,830.84, which was disallowed by the respondent. The respondent included as additional income of the individual petitioners all amounts expended by the corporation in connection with the boats. Inasmuch as the individuals were on a fiscal year ending October 31, whereas the corporation was on a calendar year basis, the respondent determined the amounts which had been expended during the taxable years of the individuals. For the fiscal year ended October 31, 1949, the respondent attributed additional income to the individuals in the amount of \$16,401.51, consisting of \$1,149.82 of disallowed corporate expenses to October 31, 1949, \$561.39 repre-

senting additional boat expense paid by the corporation and not deducted on the corporate return, and \$14,690.30 representing the amount paid to the petitioner by the corporation and capitalized on the corporate return. For the fiscal year ended October 31, 1950, the respondent attributed additional income to the individuals in the amount of \$16,595.31, consisting of \$1,005.74 expended by the corporation as boat expenses from November 1, 1949 to December 31, 1949, \$7,956.50 of net expenses from January 1, 1950 to October 31, 1950, and \$7,633.07 expended during the year ended October 31, 1950 and capitalized by the corporation.

On June 29, 1951, the corporation filed a claim for refund of taxes for the year 1949, based upon the carry-back of a claimed net operating loss for 1950. On August 19, 1952, the corporation filed another claim for refund for the year 1949, based upon a claim that it understated its net operating expenses by the amount of \$561.39 referred to hereinabove.

The activities of the petitioner and the corporation during the years in question with respect to the boats were not conducted with the intention of making a profit. Such activities did not constitute the conduct of a trade or business by either the petitioner or the corporation.

Salary Issues

Jen-Cel-Lite Corporation. The petitioner was employed in some undisclosed capacity by the Jen-Cel-Lite Corporation. At a meeting of the board of

directors of that corporation on November 19, 1949, his salary was fixed at \$4,000 for the period July 1, 1949 to November 30, 1949, and at \$800 per month thereafter. The Jen-Cel-Lite Corporation operated on the basis of a fiscal year ending November 30th. In the joint return of the individual petitioners for their taxable year ending October 31, 1950, there was included salary from Jen-Cel-Lite Corporation in the amount of \$9,600, this being at the rate of \$800 per month for 12 months. The amount which properly should have been included as taxable income by the individuals in the return for the year ending October 31, 1950, is \$12,800. The respondent increased the reported income to \$12,800 and determined an addition to tax for that year under authority of section 293(a) on account of the omission of the \$3,200.

The return in question was prepared by a public accounting firm. It was Sayres' practice to furnish such firm with information as to deductions and interest and donations, and income items such as dividends. The accounting firm also audited the books and prepared the returns of American Automobile Company and Jen-Cel-Lite Corporation. The error of the accounting firm in failing to include the proper amount of salary from Jen-Cel-Lite Corporation was due to confusion resulting from the different fiscal years of the corporation and of the individual petitioners. The petitioner was unaware of this omission until it was brought to his attention by the accounting firm after the revenue agent had discovered the omission and called it to the atten-

tion of the accounting firm. The part of the deficiency for the taxable year of the individual petitioners ended October 31, 1950 which is attributable to the omission from the joint return of the \$3,200 of salary income is due to negligence within the meaning of section 293(a) of the Internal Revenue Code of 1939.

American Automobile Company. The American Automobile Company operated on the basis of a fiscal year ending April 30th. At a meeting of the board of directors of that corporation held on April 23, 1948, the petitioner's salary as president was fixed at \$42,000 "for the year ending April 30th, 1948." The petitioner's annual salary had previously been \$30,000, which had been credited at the rate of \$2,500 monthly. An entry was made on the books of the corporation on April 30, 1948, crediting the petitioner with an amount of \$12,000 to reflect the increase in salary for that fiscal year of the corporation. That entry was never reversed and the corporation included this amount in its deduction for salaries. The corporation withheld tax on a total of \$48,000 and the individual petitioners took credit on their returns for their fiscal year ended October 31, 1948 of the full amount withheld. Such salary of \$42,000 was continued through the succeeding fiscal year of the corporation.

The proper amount of Sayres' taxable salary from American Automobile Company for his fiscal year ended October 31, 1948 was \$48,000, consisting of \$15,000 originally credited for the first six months of his fiscal year, \$21,000 credited to him at

the higher rate for the last six months of his fiscal year, and the amount of \$12,000 credited to him on the books of the corporation on April 30, 1948, representing a retroactive increase in salary for the corporation's fiscal year ended April 30, 1948.

In their separate income tax returns for their fiscal year ending October 31, 1948, each individual petitioner reported the salary from American Automobile Company at \$42,000 and each reported \$21,000 as community income. Each of these returns was prepared by the public accounting firm which customarily prepared the returns of the individuals. The accounting firm committed error in including the incorrect amount in each return. Its error was due to failure to recognize the effect of the different taxable years of the corporation and the individual petitioners. The individual petitioners were not aware of any error in their returns in this respect until the public accountant advised them at the time of the revenue agent's examination in November 1951.

In determining the deficiency the respondent increased the reported community income of each individual petitioner by the amount of \$3,000 and determined an addition to tax pursuant to section 293(a). The part of the deficiencies for the taxable year of the individual petitioners ended October 31, 1948 which is attributable to the omission from their returns of \$6,000 of salary income is due to negligence within the meaning of section 293(a) of the Internal Revenue Code of 1939.

Opinion

The answers to the questions here presented for decision depend upon whether the activities involving the designing, construction, operation and racing of the speed boats constituted, in the years in controversy, a business of the petitioner American Properties, Inc., or whether they constituted the personal hobby of the petitioner Sayres, sole owner of the corporation. There can be no question that prior to the years in controversy such activities were purely the hobby of the individual. The record is replete with evidence to this effect. He had an insatiable desire for speed, and in his testimony he conceded that racing had been his hobby. Prior to the years in question the business of the corporation consisted of owning and renting a building to the petitioner's other corporation, American Automobile Company, which operated an automobile dealership or agency.

The parties devote much of their argument to the question whether title to the boats was in the petitioner or in the corporation. The evidence shows that at a meeting of the directors of the corporation held on August 31, 1949, the petitioner stated that he was willing to transfer title to Slo-Mo-Shun III to the corporation if the corporation would continue to work out improvements in design and engineering. The minutes recite that it was agreed that it was to the best interest of the corporation to enter this new field and that Sayres was authorized to proceed accordingly. The corporation paid the petitioner \$14,960.30 purportedly as purchase price,

which was the amount that had been expended by the petitioner in the construction of Slo-Mo-Shun III and of partial construction of Slo-Mo-Shun IV. Thereafter it continued to pay all costs of construction and operation of the boats. These facts would tend to indicate that it was the intention to transfer title to Slo-Mo-Shun III and the partially constructed Slo-Mo-Shun IV to the corporation. On the other hand, there is other evidence which tends to indicate that title did not pass. There was no formal document transferring title and the petitioner continued to hold himself out as the owner before the public. He represented himself as the owner of Slo-Mo-Shun IV during the years 1950 and 1951 in his statements made for purposes of county property taxes. Furthermore, he apparently continued to deal with the boats in the same manner as he had theretofore, including mooring or housing them at his private residence. The boats were registered in his name as owner on the records of the American Power Boat Association, and in the official programs of races his name appeared as the owner.

The question of whether title passed is not in itself decisive of the issues presented, but is merely one of the factors involved in the more important question of whether the corporation did enter into a true business venture of exploiting these racing boats for profit. The determination of whether the activities of a taxpayer constitute the carrying on of a trade or business requires an examination of the facts in each case. *Higgins v. Commissioner*, 312

U.S. 212. It has been held that whether an enterprise is conducted as a business for profit is a matter of intention and good faith, and all the facts in a particular case are to be considered. *Commissioner v. Field* (C.A. 2), 67 F. 2d 876, affirming 26 B.T.A. 116. See also *Doggett v. Burnet* (C.A.D.C.), 65 F. 2d 191; *Thacher v. Lowe*, 288 Fed. 994; *Edwin S. George*, 22 B.T.A. 189.

Thus, the issues in the final analysis turn upon the question of whether during the years in question the petitioner and the corporation had the requisite intent or motive of making a profit. Intention is a question of fact to be determined not only from the direct testimony as to intent, but from a consideration of all the evidence, including the conduct of the parties. The statement of an interested party of his intention and purpose is not necessarily conclusive. *Helvering v. National Grocery Co.*, 304 U.S. 282, affirming 35 B.T.A. 163. In *R. L. Blaffer & Co.*, 37 B.T.A. 851, *affd.* (C.A. 5), 103 F. 2d 487, *cert. denied* 308 U.S. 576, we stated that one's categorical statement may be of less weight than the facts and circumstances which affect it and that "To be skeptical of the weight to be accorded an interested witness' statement in view of other evidence is not the same as wholly to reject the statement as if it were dishonest."

The petitioner testified that while watching the Gold Cup races at Detroit in 1948, he, Jensen and Jones conceived the idea that there might be a profit in the designing, construction, and sale of racing boats. Thereafter he discussed the possibilities

with his banker and financial adviser, his attorney, and his accountant and they all agreed that there were profit possibilities, and the corporate form was recommended. There was some testimony as to profit possibilities in sale of rights to the design of the boats, but the evidence shows that the boat designs were not patented and the petitioner expressed his belief that they were not patentable. He testified that he constructed Slo-Mo-Shun IV and Slo-Mo-Shun V primarily because there was a good business opportunity. His attorney testified that the petitioner entered into the corporate venture with the idea of its being a profit enterprise. The petitioner testified that the further they went in the development of these boats the more convinced he became that there could be a commercial field resulting from revolutionizing hydroplane racing boats. He stated that the most startling way to do that would be to break the straightaway record that Sir Malcolm Campbell had held for 11 years.

While we do not doubt that the petitioner and others held the belief that there was a profit possibility, we do not believe, in the light of other testimony of the petitioner and others and the conduct of the petitioner, that there was an intention or motive of immediately embarking upon a business venture. Rather, we believe that the parties had in mind merely the possibility of entering into a commercial venture at some future time when it might be deemed expedient to do so. The evidence shows that this never did eventuate.

The minutes of the meeting of the directors of

the corporation held on August 31, 1949, state that the corporation was to proceed "with the end in view of when the time was propitious getting into commercial operation." This left the intended time of actually entering into business in an uncertain state. Actually no boats were ever produced except the particular racing boats Slo-Mo-Shun IV and Slo-Mo-Shun V, which were not intended for sale but rather to be entered in the Gold Cup races with a view to winning those races, and there is no showing of any attempts to sell any boats, to build any for sale, to build any on a fee basis, or to sell any plans or designs for boats. It is contended that testing and proving the boats was a necessary preliminary step in the business of building and sale of boats. However, despite the fact that Slo-Mo-Shun IV did establish a new world speed record in June 1950 and did win the Gold Cup in July of that year, the corporation, which had no boat-building facilities and had no continuing contract with Jensen for building, did not proceed to provide boat-building facilities or take the ordinary steps which might be expected of a business organization looking toward making a profit, such as advertising or making other selling attempts. On the contrary, when Slo-Mo-Shun IV won the Gold Cup race, Jones, the designer and driver, was approached by others seeking boats of this design and one person offered large prices for two boats, but when Jones relayed these offers to the petitioner the latter told him "That we wouldn't be building for anyone." Jones gathered from the

conversation with the petitioner that the reason was that the petitioner did not want any competition from other boats of the Slo-Mo-Shun design. The petitioner testified that he did not attempt to talk to this prospective purchaser, but that he "wanted somebody to talk directly to me about it." He said that he was not interested in making a profit on the Slo-Mo-Shun IV because if he had sold it in 1950 it would have ended any hope of "going on with the development, continuing development and getting into the boat business." He admitted that he had stated for publication in newspapers that he would not sell unless he had another boat ready for competition for the Gold Cup, this being necessary because if he failed to defend the Cup it would move out of Seattle and he would be unpopular in the area. We note that according to Jones' testimony the prospective purchaser did not desire to buy Slo-Mo-Shun IV, but wanted to have two similar boats built, at what Jones stated was a good price. Jones further testified in effect that the reason no other boats were built after Slo-Mo-Shun V was because that particular boat sufficed for the 1951 racing season and that the petitioner did not suggest the building of any further boats.

It would seem that a "propitious" time for actively going into production and sale would have been in 1950 after winning the Gold Cup race. The petitioner's refusal to proceed at that time is certainly not consistent with the claim that he was interested in profit. On the contrary, it indicates

a continuation of the hobby for his personal pleasure and satisfaction. In August, 1951, the corporation borrowed \$26,000 to be used in connection with the boats, but this was after his refusal of offers to buy boats and cannot be considered as indicating a profit motive.

About November 1, 1951, Jones left Seattle and went to work for a boat designer in the east. In January, 1954, he commenced building boats of the Slo-Mo-Shun design for various individuals. The petitioner testified that Jones' departure was the reason that the originally conceived idea of producing racing boats did not ultimately materialize on a commercial basis. No reason is given for his departure and we think it is indicative that he was convinced that there would be no commercialization of the boats.

It is also noted that the operation of the Slo-Mo-Shun boats and expenses of their competition were financed in substantial amount by public contributions through the civic organization, Greater Seattle, Inc. We seriously doubt that a man of the community standing of the petitioner would have permitted these public subscriptions on the public understanding that the operation of the Slo-Mo-Shun boats was a nonprofit hobby if such had not been the case. At various times the petitioner in interviews with the press referred to himself as the owner of the boats and referred to his activities as his hobby. In letters which he addressed in 1953 to a newspaper editorial writer in response

to an editorial concerning him and his boating activities, the petitioner stated that he had personally spent more than \$100,000 in building and developing the Slo-Mo-Shuns, and that no tax adviser had yet been able to tell him how to deduct these very substantial sums for either business or personal income tax purposes.

Upon a full consideration of all the evidence, we are constrained to the view that during the years in question the activities of the petitioner and the corporation with respect to the boats were not conducted with the intention of making a profit and that such activities did not constitute the conduct of a trade or business by either the petitioner or the corporation, and we have so found as a fact. There have been a number of cases, some of which are referred to hereinabove, involving activities which partook to some extent of the nature of hobbies (such as farming, horse racing, horse breeding, dog raising, etc.) which were held to constitute businesses justifying the deduction of losses for tax purposes. However, such cases are distinguishable in that in each the taxpayer had definitely embarked upon business activities with intent to make a profit. In none of them did the taxpayer merely have in mind the thought of possibly engaging in business activities for profit at some future time, as is true in the instant case.

We hold that the corporation is not entitled to deduct the cost of maintenance and operation of the boats under section 23(a)(1) of the Internal

Revenue Code of 1939, as ordinary and necessary expenses paid or incurred in carrying on a trade or business and that it is not entitled to deductions for depreciation on the boats, irrespective of whether title to the boats was in the corporation, since section 23(1) requires, as a condition to such depreciation deductions, that the property be used in a trade or business.

The respondent has held that the amounts paid by the corporation for construction, operation, and maintenance of the boats, including the amount paid to the petitioner in reimbursement of his previously incurred expenditures, are taxable income to the individual petitioners. The respondent in so holding did not limit himself to the theory of constructive receipt of dividends and on brief states that these expenditures constitute a diversion of corporate funds by the dominant stockholder for his personal benefit and as such constitute additional income to him, citing *Davis vs. United States* (C.A. 6), 226 F. 2d 331, cert. denied 350 U.S. 965. We have hereinabove held that the expenditures were not incident to a business carried on by the corporation. We are satisfied that, irrespective of whether title to the boats was in the petitioner, such expenditures were made for his personal pleasure or to gratify his personal or civic pride in the accomplishments of these racing boats. The respondent's determination that these amounts are taxable to the individuals is *prima facie* correct and the petitioners have not shown error in his determination. It is well settled that payments made

by a corporation on behalf of its stockholder may constitute taxable dividends to the stockholder. *Louis Greenspon*, 23 T.C. 138, *affd.* on this issue (C.A. 8), 229 F. 2d 947; *Oreste Casale*, 26 T.C. 1020, on appeal (C.A. 2); *Paramount-Richards Theatres, Inc. vs. Commissioner* (C.A. 5), 153 F. 2d 602. The petitioners have not shown that there were not earnings and profits available in the corporation out of which the amounts in question could be paid and be properly treated as taxable dividends. The corporate returns indicate that there were sufficient earnings and profits available. The respondent's determination that the amounts in question are taxable to the individual petitioners is approved.

The petitioners contend, alternatively, that if the corporation was not engaged in the business then they were, and that the amounts, if taxable to them, would also be deductible by them. As stated above, we think that neither the corporation nor the individual petitioners was engaged in the business. Rather, the expenditures were in furtherance of the private hobby of the petitioner Sayres and as such may not be deducted in view of the provisions of section 24(a)(1) of the Internal Revenue Code of 1939.

The individual petitioners concede that the respondent properly increased their reported taxable income from salary of *Jen-Cel-Lite Corporation* by the amount of \$3,200 for their fiscal year ending October 31, 1950. However, they dispute the de-

termination of an addition to tax under section 293(a) of the Internal Revenue Code of 1939.²

They contest the respondent's determination that for their fiscal year ending October 31, 1948, they had additional salary income from American Automobile Company in the amount of \$6,000, and also contest the determination of an addition to tax for that fiscal year under section 293(a).

The petitioner Sayres testified and contends that it was not intended that his increase in salary voted by American Automobile Company on April 23, 1948 was to be retroactive to the beginning of the corporation's fiscal year which began on May 1, 1947, but that it was intended that it should be prospective commencing May 1, 1948. If this were true then the increase of \$1,000 per month would result in the receipt of taxable salary by him of only \$36,000 for his fiscal year ending October 31, 1948. However, for that year there was reported by the individual petitioners in their returns the amount of \$42,000 as salary. We have carefully examined the resolution passed by the directors of the corpo-

² Sec. 293. Additions to the Tax In Case of Deficiency.

(a) Negligence.—If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272(i), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

ration and we do not find it ambiguous to any extent. It clearly increased the petitioner's salary to \$42,000 "for the year ending April 30th, 1948." Furthermore, the petitioner was credited on the books of the corporation with an amount of \$12,000 to reflect the increase for that fiscal year of the corporation. It is true that some portion of the \$12,000 related to a period prior to the commencement of the petitioner's fiscal year ended October 31, 1948, but nevertheless such full sum of \$12,000 first became available to him in his fiscal year ended October 31, 1948 and must be treated as taxable income to him in that year. Even though there may have been some misunderstanding as to when the increase should commence, the fact is that the petitioner was actually credited with the \$12,000, no correction was ever made, and the corporation deducted such full amount. Upon the record we have concluded that \$48,000 was the proper amount of taxable salary of the petitioner from American Automobile Company for his fiscal year ended October 31, 1948. We approve the respondent's determination in this respect.

The individuals contend that they should not be held liable for an addition to tax under section 293(a) because of the fact that they were not aware of any omissions from their returns until 1951 when the revenue agent discovered the errors, and that they relied upon an accounting firm to obtain the proper information as to salary from the two corporations. They also state that the errors of the accounting firm in failing to determine the proper

amount of salary income were not unreasonable but are understandable because of the confusion arising by virtue of the difference between the fiscal years of the corporations and of the petitioners. The point is also made that the individuals, and also the accountants, would not be put on notice of omissions by an examination of the W-2 forms furnished by the corporations because of the fact that on such forms the data was submitted on the basis of a different time period.

There is no question here as to the good faith of the petitioners. Wholly aside from the question of good faith, a taxpayer may be guilty of negligence requiring the imposition of an addition to tax on account of negligence. *Evans v. Commissioner* (C.A. 8), 235 F. 2d 586, affirming a memorandum opinion of this Court, cert. denied 352 U.S. 909. It is well established that the duty of filing accurate returns cannot be avoided by placing responsibility upon an agent. *Vern W. Bailey*, 21 T.C. 678; *Harold B. Franklin*, 34 B.T.A. 927; *Irving Fisher*, 30 B.T.A. 433. And we have held that taxpayers must bear the responsibility for the failure of their agents, *Hyman B. Stone*, 22 T.C. 893.

Here it is admitted that \$3,200 in salary from Jen-Cel-Lite Corporation was erroneously omitted, and we have held that \$6,000 of salary from American Automobile Company was erroneously omitted. The petitioners now contend that the increase in salary voted by American Automobile Company was not intended to be retroactive, but the facts are that Sayres was credited with the full amount of

\$48,000 on the books of the corporation, that the corporation deducted such amount and withheld tax on that amount, and that the individual petitioners took credit for such withholding. Furthermore, in their separate returns they did return a total of \$42,000 which includes \$6,000 in excess of what they should have returned had the increase not been retroactive.

The fact that the individual petitioners and the corporations operated upon the basis of different taxable years is not a valid excuse for the failure to exercise due diligence. This situation is not unusual. Accountants preparing returns encounter it frequently. Here the accounting firm certainly knew about the different fiscal years since it audited the books of the corporations and prepared the returns of both the corporations and the individuals. There should have been such an investigation made either by the petitioners or by the accounting firm as would have disclosed the correct amount of salary received by the petitioner or credited to him in his fiscal years which are in question. This was not done. One of the members of the accounting firm testified that the particular accountant, now deceased, who was handling this matter failed to consult the audit papers and that he did not reconcile the deductions taken by the corporations for salaries with the personal returns of the individuals. He further testified that the accountant did not go to the files of the American Automobile Company to see what amounts had been credited to Sayres and therefore overlooked the credit of \$12,000 on the

books of that company. He stated that unquestionably a mistake was made and that it came to light only when the revenue agent made his examination. He also stated that Sayres was of the opinion that there was negligence in the accounting office, that these items should have been discovered, and that the accountant did not do what he should have done.

Under these circumstances we have concluded and have found as a fact that the portions of the deficiencies due to omissions of salary income were due to negligence within the meaning of section 293(a).

The cases of R. E. Nelson, 19 T.C. 575 and Rhett W. Woody, 19 T.C. 350, cited by the petitioners, are not analogous. In those cases the deficiencies were not due to negligence. They were due to the erroneous tax treatment of certain items, but the taxpayers had acted in good faith in reliance on the advice of accountants who were conversant with tax matters and who were fully apprised of the facts.

The respondent's determinations of additions to the tax under section 293(a) are approved.

Decisions will be entered under Rule 50.

Served and Entered September 3, 1957.

Tax Court of the United States
Washington

Docket No. 57748

AMERICAN PROPERTIES, INC., Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed August 30, 1957, the respondent herein, on December 20, 1957, filed a recomputation for entry of decision. Hearing was had thereon on February 12, 1958, at which time the recomputation filed by the respondent was not contested by the petitioner. The premises considered, it is

Ordered and Decided: That there are deficiencies in income tax for the taxable years 1949 and 1950 in the respective amounts of \$495.78 and \$3,601.31.

[Seal] /s/ CRAIG S. ATKINS,
Judge.

Served and Entered February 14, 1958.

Tax Court of the United States
Washington

Docket No. 57751

ESTATE OF STANLEY S. SAYRES, Deceased,
Harold L. Scott and A. R. Munger, Executors,
and Madeleine A. Sayres, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed August 30, 1957, the respondent herein, on December 20, 1957, filed a recomputation for entry of decision. Hearing was had thereon on February 12, 1958, at which time the recomputation filed by the respondent was not contested by the petitioners. The premises considered, it is

Ordered and Decided: That there is a deficiency in income tax for the taxable year ended October 31, 1949, in the amount of \$10,400.69, and that there are deficiencies in income tax and in addition to tax under section 293(a) of the Internal Revenue Code of 1939, for the taxable year ended October 31, 1950, in the respective amounts of \$12,830.51 and \$641.53.

[Seal] /s/ CRAIG S. ATKINS,
Judge.

Served and Entered February 14, 1958.

United States Court of Appeals
For the Ninth Circuit

Tax Court Docket Nos. 57748 and 57751

AMERICAN PROPERTIES, INC., and the
ESTATE OF STANLEY S. SAYRES, De-
ceased, HAROLD L. SCOTT, and A. R.
MUNGER, Executors, and MADELEINE A.
SAYRES, Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States
Court of Appeals for the Ninth Circuit:

Comes now American Properties, Inc., and the
Estate of Stanley S. Sayres, Deceased, Harold L.
Scott and A. R. Munger, Executors, and Madeleine
A. Sayres, Petitioners on Review herein, by their
attorney, Kenneth P. Short, and respectfully show:

I.

That the above captioned causes bearing Tax
Court Docket Nos. 57748 and 57751, being consoli-
dated causes (with which were also consolidated
causes numbered 57749 and 57750 from which no
review is sought herein), were heard in the Tax
Court of the United States before the Honorable
Craig S. Atkins, Judge, sitting in Seattle, Washing-
ton, on May 18 and 21, 1956.

II.

An order and decision in said consolidated causes was entered February 14, 1958.

III.

This controversy involves the following questions:

(a) Did Petitioner, American Properties, Inc., enter into and carry on a racing boat venture with a profit motive in the calendar years 1949 and 1950, thereby incurring ordinary and necessary expense in the maintenance, operation and depreciation of said boat?

(b) If the answer to (a), *supra*, is "No", then were the amounts so expended by said corporation taxable income to the sole stockholders, Stanley S. Sayres and Madeleine A. Sayres?

(c) If the answer to (b), *supra*, is "Yes", then was the racing boat venture entered into by Mr. and Mrs. Sayres with a profit motive, rendering the expense of maintenance, operation and depreciation deductible?

IV.

Review is sought in the United States Court of Appeals for the Ninth Circuit. American Properties, Inc., is a Washington corporation with its principal place of business at Seattle, Washington. Stanley S. Sayres, during his lifetime, and Madeleine A. Sayres, his wife, were and are citizens and residents of the State of Washington, residing in King County, Seattle, Washington. That Harold L. Scott and A. R. Munger are the duly appointed qualified and acting executors of the Estate of Stan-

ley S. Sayres, Deceased, who died September 17, 1956, and which Estate is in probate in the Superior Court of the State of Washington for King County. That the income tax returns of all petitioners for the years in question were filed in the office of the Collector of Internal Revenue at Tacoma, Washington, within the jurisdiction of the United States Court of Appeals for the Ninth Circuit.

/s/ KENNETH P. SHORT,
Attorney for Petitioners on
Review.

Duly Verified.

[Endorsed]: T.C.U.S. Filed May 7, 1958.

[Title of Tax Court and Docket Nos. 57748 and
57751.]

NOTICE OF FILING PETITION FOR REVIEW

To: Chief Counsel, Internal Revenue Service.

You are hereby notified that Petitioners on Review, by their undersigned counsel, did, on the 7th day of May, 1958, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a Petition for Review by the United States Court of Appeals for the Ninth Circuit, of the decision of the Tax Court theretofore rendered in the above-entitled consolidated causes. A true copy of the Petition for Review as filed is hereto attached and served upon you.

Dated this 7th day of May, 1958.

/s/ KENNETH P. SHORT,
Attorney for Petitioners.

Acknowledgment of Service Attached.

[Endorsed]: T.C.U.S. Filed May 7, 1958.

The Tax Court of the United States

Docket No. 57748

American Properties, Inc., Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Docket No. 57749

Stanley S. Sayres, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Docket No. 57750

Madeleine A. Sayres, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Docket No. 57751

Stanley S. Sayres and Madeleine A. Sayres, Petitioners, vs. Commissioner of Internal Revenue, Respondent.

TRANSCRIPT OF PROCEEDINGS

Court of Appeals, U. S. Courthouse, Seattle, Washington, May 18, 1956.

The hearing in the above-entitled matter was convened at 9:30 a.m., before

The Honorable Craig S. Atkins, Presiding.

Appearances: Kenneth B. Short, Esq., and Tracy Griffin, Esq., and Harold L. Scott, Esq., on behalf

of the Petitioner. Gordon M. Cromwell, Esq., on behalf of the Respondent. [2]*

Proceedings

The Court: We will proceed.

The Clerk: Docket 57748, 49, 50 and 51, American Properties, Inc., Stanley S. Sayres and Madeleine A. Sayres.

Will counsel please state their appearances for the record.

Mr. Griffin: Tracy Griffin, attorney for petitioners, accompanied by one of my partners, Mr. Kenneth B. Short.

The Clerk: I believe Mr. Short is not now admitted.

Mr. Griffin: Mr. Short is not now admitted. It developed yesterday that—I am admitted—I have to be a witness. I ask Mr. Short to conduct the interrogation.

The Court: Does Mr. Short intend to make application to be admitted?

Mr. Short: Yes.

Mr. Cromwell: Gordon M. Cromwell for the respondent, your Honor.

The Court: Mr. Griffin, do you care to make an opening statement?

Mr. Griffin: Mr. Short will make the opening statement.

Mr. Short: If it please the court, counsel, there

* Page numbers appearing at top of page of Reporter's Transcript of Record.

are two basic questions presented by these three consolidated cases, two of which are related salary questions, and the first in Docket 57748, American Properties, concerning the Slo-mo-shuns, [4] the so-called racing boats, the property of the taxpayer corporation. Unless there is objection to the contrary I would prefer to proceed on the question of the status of these boats as being either as the government contends, the hobby of Mr. Sayres, or as we contend, the business function of the taxpayer, and when concluded, proceed on these salary questions, which in my opinion, will take from the petitioner's point of view, not over 30 minutes. The Slo-mo-shun question will take, I consider the motion and this array of witnesses that is present are here on that question, and I think for the convenience of them and for the orderliness in general, I would prefer to proceed on that question now.

The Court: I personally see no question.

Does the counsel for the respondent see any objection to that?

Mr. Cromwell: No, your Honor, Respondent has no objection.

Mr. Short: As I indicated, and as the petition doubtless shows——

Mr. Cromwell (interrupting): Maybe I misunderstood Mr. Short. He will put in his entire case on this boat issue before I put in my case on that issue?

Mr. Short: On that issue, yes. And when we have rested this salary question can be disposed of briefly in my opinion. [5]

Mr. Cromwell: That is agreeable, your Honor.

Mr. Short: The question arises as the petition indicates, for the Years 1949 and '50 on the respondent commissioner's review of those returns and assessing to the taxpayer Sayres, which affects both the taxpayer American Properties, Inc., and Sayres, that the acquisition by the corporation from Sayres of the racing boats constituted a constructive dividend, and on the theory that the racing boats were the hobby of Mr. Sayres and, therefore, it followed that if that theory was correct that the expenses in those corporate returns for those years and the depreciation of allowances taken were also improperly there. I think that this case does not involve any dispute in mathematics of figures, that is, if one theory is correct, the government is correct, and if we are correct, the returns are correct.

Getting down to the ultimate question, then, of whether the vessels, racing vessels, are the bauble of Mr. Sayres or whether they are a legitimate business venture of American Properties, Inc., the evidence will show substantially as follows:

That Mr. Sayres has pursued speed since he was a kid, which, in fact, led him into automobiles in his youth, and ultimately into the automobile business, and he has been, for many years, until a month or so ago, principally engaged in the sale of automobiles. In the early 30's, I think it will be 1931, he came to Seattle and acquired a pre-existing corporation called Williams Motors, the name of which he immediately changed to [6] American Properties, who is the taxpayer in this proceeding.

In the early 40's he had developed some fairly startling speeds in racing boats, but in the latter part of 1948 and early 1949 he, in conjunction with Ted Jones, who was then an engineer at Boeing, and Anchor Jensen, who had been in the boat building business, and, his father before him since the beginning of time in Seattle, developed a new design which, in the opinion of Sayres, would revolutionize boat racing, and the idea was conceived that if Sayres, Jones, Jensen, were correct that the existing straightaway speed limit which had existed for 11 or 12 years, could be broken with this new design, that that type of design would be a marketable commodity, not only to the racing fraternity, which is generally centered in the Detroit area, among wealthy persons who can afford to buy an item of that kind, but further, that they would have a market with the Navy as a redesign of the existing PT boat or torpedo launching vessel.

With that in mind, counsel, Mr. Griffin, the financial adviser of Mr. Sayres, A. R. Munger, and the auditor, Mr. Harold Scott, were consulted, and it was concluded that they would organize a corporation for the manufacture and sale of these boats until it was discovered by Mr. Griffin that the William Automobile Company original articles of incorporation included that corporation for that purpose. That being so, the purpose of organizing a separate corporation disappeared, [7] and the existing company, American Properties, Inc., was used for that purpose. That, the evidence will show, was at a time when, that is, the purchase of the

then existing Slo-mo-shun III by the corporation from Sayres, was at a time when Slo-mo-shun IV, which is the new design, the new Jones-Jensen product, was then abuilding, had not yet touched the water. The III was purchased by the company and the IV was completed in 1950, and as predicted by Mr. Sayres——

Mr. Griffin (interrupting): Pardon me, Mr. Short. The Slo-mo-shun IV was completed in October 1949.

Mr. Short: Yes. It first competed in 1950.

Mr. Griffin: That is right.

Mr. Short: As anticipated by Jones-Sayres-Jensen, on January 26, 1950, Mr. Sayres in the Slo-mo-shun IV rendered obsolete every unlimited racing boat in the United States by establishing a record of 160.3235 miles per hour on Lake Washington in the Slo-mo-shun IV.

The Court: What does Slo-mo-shun mean?

Mr. Short: It is a clear misnomer. I have never inquired where that name came from. It is the opposite of what the boat is.

And, therefore, the purpose of the business venture of American Properties, Inc., in going into these vessels was fully justified. The evidence will further show that there came to bear on the construction and operation of these vessels, [8] not only then but in subsequent period, the finest technical and engineering talent that American can produce from the airlines, petroleum companies, engineering personnel and drivers.

It will appear, despite the government's contention that this is a hobby of Mr. Sayres personally, that Mr. Sayres drove the boat on the straightaway speed making records, but he did not drive these vessels in competition. They have won the gold cup, which is a competitive racing award, not a straightaway time or speed award, the silver cup, and the Harmsworth Trophy.

The evidence will further show that Jones, who is the designer—illustrate to you briefly that the departure from normal design in these vessels is that by reason of simple physics and a little bit of aerodynamics when these vessels get underway unlike other vessels they rise out of the water and they ride on the water on two small points on each side of the vessel, and the driving mechanism is in the rear so that all the ordinary water pressure that keeps a boat from going at unlimited speed is out of the vessel, the vessel is out of the water. Jones, who designed this type of thing, and Mr. Jensen disagreed on many things, and the combination of these three people separated them so that in part, that in part, is responsible for the fact that the business venture as such did not go forward. The boat is not ultimately commercially bought and sold. Jones, however, is, or claims to be, the designer of [9] nearly all of the present competitive high speed unlimited class hydroplanes and has built, in accordance with his letter, at least, to the editor of Sports Illustrated, a list of vessels which will race in the coming Sea Fair trophy race which is a \$25,000 prize award race to be held here this coming

summer, and in the Gold Cups which are held traditionally in August.

The total purport of the petitioner's case will be to demonstrate to the court that in its origination and throughout the years in question, although a money-losing venture, it was conceived and originated and proceeded forward on a profit-making theory, and with that intent and purpose in mind, and that from a construction and design point of view, it was about to succeed when the personnel involved departed from the company.

The Court: Mr. Cromwell, do you have a statement to make?

Mr. Cromwell: If the Court please, respondent's position regarding the boat expense disallowed to American Properties, Inc., 1949 and 1950, is that such expenses were not ordinary and necessary business expenses.

The Court: May I interrupt for a moment to ask, is there any stipulation, are some of the facts stipulated?

Mr. Cromwell: None of the facts are stipulated.

The Court: Why is that? Wouldn't it be possible to stipulate some of the facts?

Mr. Cromwell: Several weeks ago we had a meeting, [10] the appellate division, and Mr. Harold Scott was there, and Mr. Griffin, he complained, I had served a subpoena on Mr. Sayres to produce certain books and records, he complained about that, and I told him he could be relieved of that if he could get together and stipulate with me on certain facts, particularly with regard to the salaries,

and he said that he would do that, and I have heard nothing further in that regard.

The Court: Well, of course, our Rule 31 requires of the parties to try and get together and stipulate such facts as are not in controversy, for example, I have been wondering what Mr. Sayres' relation to the corporation is. Is that admitted or stipulated or anything of that sort?

Mr. Cromwell: We will bring that out, your Honor.

Mr. Griffin: May I say, I am of record in this matter, and no approach was made to me at any time on any matter.

The Court: It is the joint responsibility of the counsel. I am very sorry that you weren't able to get together but I see at this stage nothing to do but go ahead.

Mr. Griffin: I was engaged in a trial in Tacoma that was going to last a week, and it lasted three. I got home night before last.

The Court: Well, as we go along there may be certain things you can agree upon.

Mr. Cromwell: In this same regard, your Honor, regarding the expenses, the boat expenses, claimed boat expenses disallowed [11] to American Properties, Inc., in 1949 and 1950, Mr. Short stated, I believe, that there was no dispute regarding the figures, it was just a question of the title of this boat and so forth. It is inherently respondent's determination that the expenses were not ordinary and necessary business expenses, that those matters be

sustained by petitioner, too, or at least, he carry the burden of proof on those matters. We do not agree to those figures. Respondent's position regarding the disallowance of the depreciation deduction on the boats and related equipment claimed by American Properties, Inc., for 1950 is that those assets were not used in the trade or business of the corporation and were not held for the production of income.

There is also at issue in this proceeding dockets concerning the tax years 1949 and 1950 of Mr. and Mrs. Sayres, the amounts of \$16,401.53 for 1949 and \$16,595.61 for 1950, which were added to the income of Stanley and Madeleine Sayres for those tax years. Respondent determined that these sums represented taxable income from the taxpayers' wholly-owned corporation, American Properties, Inc. In referring to the taxpayer I refer to Stanley Sayres, these two amounts are made up in part of expenses disallowed to American Properties, Inc., in 1949 and 1950 for the operation and maintenance of the several racing boats that Stanley Sayres claims were owned and operated by American Properties for business purposes. The balance of those items is made up of amounts of capital expenditures claimed to have been made in 1949 and 1950 on these boats by American Properties.

Now, the corporation is using a calendar year basis for accounting for income. The taxpayers, on the other hand, are using a fiscal year for accounting for their income, the fiscal year ends October 31, so there is an overlapping of expenses, and it is

difficult to understand or explain unless you see the schedule of just how it is broken down.

The Court: You say the individual is on the fiscal year?

Mr. Cromwell: The individual is on the fiscal year, your Honor, ending October 31. So, I have had the technical adviser prepare a schedule showing just the reconciliation of this matter and just how these two approximately \$65,000 items are arrived at. And, if counsel for petitioner will agree, I offer that as an exhibit in aid to the court in following this case.

Mr. Griffin: I think we will agree, subject to checking this so that we don't delay the court.

Mr. Short: I have no objection to that.

The Court: Very well.

Mr. Cromwell: Will you mark this Respondent's Exhibit A.

The Court: It will be received in evidence.

(Respondent's Exhibit Number A [123] was marked for identification and received in evidence.)

Mr. Cromwell: The respondent determined these amounts to be income to Stanley and Madeleine Sayres and, incidentally, I might say that respondent did not limit its determination to constructive dividends; respondent has stated in its statutory notice it was additional income. Respondent determined these amounts to be income to Stanley and Madeleine Sayres on the alternative grounds that, first, title to the Sio-mo-shun was never in American Properties but was in Stanley Sayres and,

second, even if bare legal title was in American Properties, it derived no benefit from the boats, and all the benefits of the maintenance and operation of the boats was innured to Stanley Sayres since, at all times, these boats have been nothing more than his expensive hobby and he has always held them out to the public, also held himself out to the public, as being their owner.

Now, your Honor, Respondent stipulated with petitioner's counsel, Mr. Griffin, that we would agree to excuse one of respondent's witnesses this morning if he would stipulate to an article that appeared in the newspaper under the witness' by-line. The witness is Royal-Brougham.

Mr. Griffin: Yes, I so stipulate, anything under Mr. Brougham's by-line in the *Post Intelligencer* I will admit he wrote. [14]

Mr. Cromwell: And there is also a quotation in here, Mr. Griffin, I call your attention to, by Mr. Sayres, according to Mr. Brougham, do you admit that he made that?

Mr. Griffin: I don't admit he made that statement.

Mr. Cromwell: Do you admit Mr. Sayres made that statement?

Mr. Griffin: No, I do not, as a matter of fact, I haven't even seen the article. We will have Mr. Sayres here to testify as to whether he made the statement or not.

We also agree to take Mr. Brougham's deposition.

Mr. Cromwell: We also agree to take Mr.

Brougham's deposition, your Honor, in case this proceeding is finished by today. Mr. Brougham will be back by Monday morning, and if we go over, he will be here, but in case he isn't, Mr. Griffin has stipulated with me to take his deposition.

Mr. Griffin: That is correct.

The Court: Very well.

Mr. Cromwell: Respondent's Exhibit B is offered in evidence.

The Court: Very well. It is my understanding now this is merely an admission on the part of counsel for the petitioner that this is an article that appeared, one of Mr. Brougham's articles?

Mr. Cromwell: That is correct, your Honor.

The Court: You do not admit the truth of it or any [15] facts stated in his article?

Mr. Griffin: That is correct.

Mr. Cromwell: For the purposes of the record, your Honor, I would like to state that the article appears in the Seattle Post Intelligencer newspaper, Friday, September 8, 1950, page 14. The article is entitled "The Morning After."

Mr. Griffin: You may not be as familiar with that, that has been Mr. Brougham's column for a great many years in the Post Intelligencer. He is the sports editor.

On counsel's request for a stipulation on the quotation therein which I just now read, I am perfectly willing to stipulate to the entire substance. I wouldn't stipulate to a direct actual quo-

tation, but the entire substance of the quotation I will stipulate is correct, or is factual.

Mr. Cromwell: That is in respondent's Exhibit B, Mr. Griffin?

Mr. Griffin: Yes, I take it you were asking me as you pointed it out to me, "I always like to go fast". Is that what you mean, what Mr. Sayres said?

Mr. Cromwell: I will stipulate that that was made by Mr. Sayres.

Mr. Griffin: It may not be the actual language but the substance, I will stipulate that is the substance.

The Court: Very well, it is so understood.

(Respondent's Exhibit Number B [16] was marked for identification and received in evidence.)

Mr. Short: I will call Mr. Sayres.

STANLEY S. SAYRES

was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name and address?

The Witness: Stanley S. Sayres, 4450 Huntpoint Road, Bellevue. That is my residence address.

Direct Examination

Q. (By Mr. Short): You are the husband of Madeleine Sayres, the other taxpayer in Docket 57751? A. Yes.

(Testimony of Stanley S. Sayres.)

Q. Mr. Sayres, before you came to Seattle, where did you live? A. Pendleton, Oregon.

Q. And when did you come to Seattle?

A. Late in 1931.

Q. What is your present age?

A. Fifty-nine.

Q. When you were in Pendleton what was your business? A. Motor cars.

Q. How did that develop, how did you happen to get into [17] the motor car business?

A. Well, I like motor cars.

Q. And did you enjoy speed?

A. Yes, that is true.

Q. When you came to Seattle did you go into the motor car business here as well? A. Yes.

Q. Did you purchase an existing motor car business? A. Yes.

Q. What was the name of that?

A. I purchased American Automobile Company.

Q. Was there a corporation named Williams Motors? A. Yes.

Q. When did you acquire that?

A. Oh, in the early days after arriving here, but I could not name you the exact date.

Q. And that Williams Motors is the corporation whose name is now American Properties, Inc., is that right? A. Right.

Q. When did you become interested in boats?

A. Well, that was before I came to Seattle.

Q. Before you came to Seattle? A. Yes.

(Testimony of Stanley S. Sayres.)

Q. And did you race boats in or around Pendleton?

A. I did some outboard racing on Coy Lake, which is a [18] small lake six or seven miles out of Pendleton.

Q. Did you continue that when you came to Seattle?

A. No, for several years I was entirely out of it.

Q. Is there, or was there a vessel named Slo-mo-shun I? A. Yes.

Q. Was that yours?

A. That is right, it didn't actually have the "I" on it. We came to numbers later.

Q. Where did that name come from?

A. Mrs. Sayres made that name. I purchased this boat, it was a used one, but it had presumably gone a little over 80 miles an hour with the previous owner, and the day the boat arrived, or the evening, we sat around the dinner table just as you might name a youngster and tossed around possible names. And, she said, "Well, it's supposed to go fast, why don't you call it Slo-mo-shun", and I said, "All right, we will put phonetic spelling on that", and that is the way the name came.

Q. There was, in due course, a Slo-mo-shun II and III, I take it? A. Yes.

Q. And those were speed boats, I take it, were they? A. Yes, racing boats.

Q. The Slo-mo-shun IV and V later developed were of a different design, were they not, than I, II, or III?

(Testimony of Stanley S. Sayres.)

A. Well, they were a progression of those early designs. [19]

Q. And who did the design work on these boats?

A. Ted Jones, that is, I am talking about IV and V now, and III.

Q. And III? A. Yes.

Q. And the construction work was done by whom?

A. Well, III and IV and V were built by Anchor Jensen or Jensen Motor Boat.

Q. Did you see any profit possibilities in III and subsequent boats?

A. Yes, I thought I did.

Q. When did you conceive that notion?

A. Well, after our own experience with the three smaller boats, that is, I, II and III, and after watching the bigger boats run at Detroit on some of the earlier Gold Cup races before we were in competition, it was certainly a unanimous opinion of Jones and Jensen and myself that there was tremendous room for improvement in those boats. As I recall it, the three of us went back to Detroit to watch the 1948 Gold Cup races and look over the boats and so on.

The Court: I don't believe the record shows who these other gentlemen are, except in your opening statement.

Mr. Short: Do you wish them more clearly identified?

The Court: I think so. [20]

Q. (By Mr. Short): Anchor Jensen is whom?

(Testimony of Stanley S. Sayres.)

A. Anchor Jensen is the manager of Jensen Motor Boat Company. That is a local boat-building firm, and he is the man who we say built both the boats. Mr. Jones is the designer of the boats.

Q. He is now, as far as you know, engaged professionally in that pursuit?

A. So far as I know, that is correct.

Q. At the time that you just made reference to in 1948, and for a few years thereafter, he was principally, was he not, an engineer?

A. He was connected with the Boeing Airplane Company.

Q. The Boeing Airplane Company?

A. That is right.

Q. You were in process of relating when you conceived the notion that there would be a profit-making possibility in these boats. I think you have said that in watching the—what, the '48 Gold Cup races?

A. Correct.

Q. Is that when you would say the idea germinated?

A. I think that is as early as you can state it. You cannot say that an idea arrived at 10 o'clock on some particular day.

Q. It is apparent from the, both positions of petitioner and respondent, that the Slo-mo-shun III was acquired by American [21] Properties in 1949. Would you relate what discussions or transactions took place leading up to the acquisition of the Slo-mo-shun III by American Properties from you?

A. Yes. The farther we went along in the de-

(Testimony of Stanley S. Sayres.)

velopment of these boats, the more convinced I became there could be a commercial field, an opportunity, you might say, to revolutionize the hydroplane race boats and what they were doing. And I certainly had in mind that the most startling way to do that would be to smash the straight-away record that Sir Malcolm Campbell held so long.

Q. How long, how long in June, 1950, had the previous record existed?

A. I believe it was 11 years, but without looking up the record, I can't be sure of that.

Q. All right. A. So then——

Q. (Interrupting) May I interrupt you once more before you proceed. When you say that the, in revolutionizing the racing boat field, well, in conceiving a commercial virtue in this revolutionizing the construction of these boats, what do you mean? I mean, what profit motive is there, is it in the construction and sale of the boats?

A. Well, construction or designing, that is, the boat might be designed simply for a fee and somebody else builds it.

Q. But not racing the boats for money, that isn't what you [22] had reference to?

A. There is no money in racing in the Gold Cup races. There never has been. I would like to add that Jones and I were both agreed that there might be another field even more important than just race boats, and that is if the navy should ever want a really high speed, well, what we might call a

(Testimony of Stanley S. Sayres.)

super PT boat. Now, whether the navy is ever going to want one or not, I don't know.

Q. After the acquisition of the Slo-mo-shun III and after the construction of IV, did you ever actually interest the navy in examining these boats?

A. There were some civilian representatives of the navy department came over to the boat house and watched the boat run and examined it. I can't tell you today their names. I don't recall. They spent several hours there.

The Court: May I interrupt, Mr. Short. A few things occur to me for my understanding here.

Now, you and the other two gentlemen were joint owners of the individual boats?

The Witness: No, I was the owner.

The Court: You were the owner?

The Witness: I was the man that put up all the money, and Mr. Jensen was paid for his work in building, and Mr. Jones was compensated for his designing.

The Court: So they had no interest in the design. [23] Was it patented?

The Witness: No, I don't think you can patent it.

Mr. Short: Ultimately I will show that the contract was entered into, if you are wondering how they participated in this.

The Witness: Mr. Jones certainly had a tremendous interest in this.

The Court: Very well, you go ahead.

Q. (By Mr. Short): When I interrupted you to

(Testimony of Stanley S. Sayres.)

bring up these details which you have now furnished us, I had originally asked you, you will recall, what you did to implement this profit, that is, what transactions you had and persons you consulted in reference to it.

A. I discussed it with Mr. Scott, who has always done my tax work, with Mr. Griffin——

Q. (Interrupting) I think you should identify these people. Harold Scott is now, is he not, a partner in Pete, Marwick & Mitchell Company?

A. Yes.

Q. Tracy Griffin is my partner here?

A. Yes.

Q. Any other persons?

A. And Mr. A. R. Munder.

Q. Would you identify who A. R. Munger is?

A. Mr. Munger was an executive of the Seattle First National Bank, and was vice-president and then became president. I don't know the exact date he became president, but I have consulted him on my business affairs from the time I moved to Seattle, and I discussed this very thoroughly with all three of these men.

Q. As a result of that discussion, what transpired, what actually did you do to implement this thought?

A. Well, they agreed that this thing had a profit possibility, and we agreed that certainly it should not be an individual venture. We had to find a place to put it. That meant a new corporation,

(Testimony of Stanley S. Sayres.)

or then, as it occurred to us, we already had one, that was American Properties.

Q. All right.

A. Now do you want me to tell any whys?

Q. No. As I understand the corporation, the present existing corporation, American Properties then went forward and acquired from you Slo-mo-shun III? A. And IV.

Q. And what there was of IV?

A. Yes, it was in a state of construction then. It was not completed.

Q. And that was in that sum of agreed amount, whatever it was, \$140,000? A. Yes. [25]

Q. Who owned, what was the——

Mr. Cromwell (interrupting): Just a moment. You stated that was in the sum of that agreed amount?

Mr. Short: The undisputed amount of what was paid Sayres for the boat.

Mr. Cromwell: That is not undisputed, that is also at issue.

Mr. Short: What is the issue?

Mr. Cromwell: You have the statement and the statutory notice.

The Court: You can furnish proof of that can't you?

Mr. Short: Yes, it will appear. I may say as an aside that it was my conception that the reason the government contended that the expenses were not usual and ordinary was because the boat was the hobby of Mr. Sayres and not because there was

(Testimony of Stanley S. Sayres.)

any dispute that the amounts were expended or that they were expended for the boats.

Mr. Griffin: I thought I heard Mr. Cromwell say in his opening statement that he did not agree to the figures. I understood him to say that he did not agree and I think you understood him to say that he agreed.

Mr. Short: I understood what he said. I will say I was surprised by what he said.

Q. (By Mr. Short): Who in 1949 owned the capital stock in American Properties, [26] Inc.?

A. I did with the exception of qualifying shares.

Q. And do you still own all *by* the qualifying shares? A. Yes.

Q. And that has been continuous?

A. Yes.

Q. When was Slo-mo-shun IV completed?

A. It was launched in October of '49.

Q. And in June, 1950, what occurred in reference to that boat?

A. Well, that is when it established the new world straightaway record.

Q. Of 160 point something. A. 160.

Q. And that was here?

A. Yes, on Lake Washington.

Q. In the perfection and development of it, and construction of the Slo-mo-shun III and IV, did you retain technical help and assistance in the design, construction, maintenance and operation of those vessels?

(Testimony of Stanley S. Sayres.)

A. Well, not so much applying to number III, but after IV was built, very definitely so.

Q. Would you indicate who some of those technical assistants were?

A. Well, going back to the very start of this, Mike Welsh. [27] Mike is from Boeing Airplane Company, a highly skilled technicalman in electronics and certain other fields. We have had at all times two men from Western Gear Works who are experts on gearing, and, of course, Western Gearing designed and built the gear boxes we used.

Q. And they advertise that fact?

A. And we had Elmer Lenin Smith who is still a member of the crew, he now is with Western Gear, but at that time was with the Marine Supply House, we had Anchor Jensen, of course, and naturally Ted Jones, we had a number of other men. The crew has had some changes, but all men that are quite specialized in certain fields.

Q. Have those gentlemen, that is, the key men in that crew, as you call it, become recognized in the United States as being the outstanding people in their respective fields?

A. I think they have.

Q. When these boats are raced in these speeds, I don't mean the straightaway, but in the Gold Cup or the Harmsworth or other trophy races, who drives them?

A. Well, there has been Ted Jones who won the first Gold Cup in 1950——

Q. (Interrupting) You are relating who is driv-

(Testimony of Stanley S. Sayres.)

ing now, is that correct? A. That is right.

Q. All right. [28]

A. Then Lou Fageol won the '51 race.

Q. Who is Lou Fageol?

A. Lou Fageol is one of the oldest and most experienced race boat drivers in the country.

Q. Would you say he is one of the top two or three in the country? A. Oh, yes.

Then, Stanley Dollar of San Francisco won the 1952 race, he was a very experienced driver, had owned his own boats for a good many years and had won the Harmsworth and a number of other important races.

Then, the following year, Joe Taggart began driving on our crew. Joe Taggart is almost an old-timer and as much racing experience as Fageol.

Q. Do I gather from your testimony that you personally do not drive these boats in competitive races? A. That is right.

Q. Gold Cup or Harmsworth races?

A. That is correct.

Q. Is it fair to state, then, that your desire or enthusiasm for speed is not satisfied by driving the Slo-mo-shun IV or V in racing competition, you do not satisfy it in that manner?

A. No, I would like to, but there are some good reasons not to.

Q. And you haven't? [29]

A. I have not.

Q. Other than the original breaking of the

(Testimony of Stanley S. Sayres.)

world record in June 23, 1950, have you driven these boats or either of them competitively?

A. No.

Q. Are these——

A. (Interrupting) You are talking about major closed course competitive race?

Q. Yes. A. Yes.

Q. Speed competition things. You do drive boats? A. Yes.

Q. When the occasion permits? A. Yes.

Q. I started to ask you a question and got away from it. The question I was about to ask you, are these susceptible to pleasure cruises, that is to say, can you take your family in either the IV or V for a boat ride?

A. No, number V only had one seat for the driver, number IV has a mechanic's seat, you can take one passenger in the boat.

Q. You don't take Mrs. Sayres, then, I take it, out on Sunday in these boats?

A. No, it is not a regular procedure.

Q. When you and Jones and Jensen had conceived this thought [30] that the design of the Slo-mo-shun IV was, as it was progressing, might be profitable, did you agree on any terms by which Jones and Jensen might participate in the success of these boats?

Mr. Cromwell: Just a moment, please. Will you specify as to what year they were to become profitable?

Mr. Short: No, I didn't.

Mr. Cromwell: You never did specify that.

(Testimony of Stanley S. Sayres.)

Mr. Short: Your question is, will I specify when that became profitable, my answer is no.

Mr. Cromwell: He has mentioned when he thought it would become profitable, but he has never mentioned a year.

The Court: You mean the year when the thought occurred to him?

Mr. Cromwell: When he thought it would become profitable.

Mr. Short: I misunderstood the question. I thought I asked him that and I thought he said it germinated at the Gold Cup races in 1948.

Q. (By Mr. Short): That would be August?

A. Yes.

Q. When did you get down to these discussions with Munger, Scott and Griffin in reference to actually doing something about it?

A. Those discussions all came along, I am sure, after we [31] had number IV in the water and had begun making our preliminary runs and decided we had a boat that was superior to anything in the picture.

Q. Now, to get back to——

Mr. Short: Will you mark this?

The Clerk: Petitioner's Exhibit 1 for identification.

(Petitioner's Exhibit Number 1 was marked for identification.)

Mr. Short: Will you mark this now?

The Clerk: Two for identification.

(Petitioner's Exhibit Number 2 was marked for identification.)

(Testimony of Stanley S. Sayres.)

The Clerk: And Petitioner's 3 for identification.

(Petitioner's Exhibit Number 3 was marked for identification.)

Mr. Short: I will offer Petitioner's Exhibit 2 for identification, which is a certified copy of the original articles of incorporation of Williams Auto Company, and Petitioner's Exhibit 3 for identification, which is a certified copy of the amendment to those articles simply changing the name to American Properties, Inc.

They are for the purpose of showing that the original articles of the taxpayer corporation authorized the construction and sale of boats and marine engines.

The Court: That would be before this petitioner [32] acquired the company?

Mr. Short: Oh, yes.

Q. (By Mr. Short): You had no interest in Williams Motor Company, or whatever its name was?

A. Yes.

Q. That pre-existed your coming to Seattle.

Mr. Short: Will you mark this?

The Clerk: Four for identification.

(Petitioner's Exhibit Number 4 was marked for identification.)

Mr. Cromwell: I object to this exhibit, Petitioner's Exhibit 2 marked for identification, it hasn't been properly identified, your Honor.

Mr. Short: It is a self-identifying document. The certificate on the back is that of the auditor

(Testimony of Stanley S. Sayres.)

of King County who is the custodian of the document with whom it must be recorded.

The Court: It will be received.

(Petitioner's Exhibit Number 2 was received in evidence.)

Mr. Cromwell: No objection to 3.

Mr. Short: I offer Exhibit 3.

The Court: They will be received.

(Petitioner's Exhibit Number 3 [33] was received in evidence.)

Q. (By Mr. Short): Mr. Sayres, I hand you what has been marked for the clerk as Petitioner's Exhibit 4 and I will ask you to state what that is.

A. Yes, this is a meeting of the Board of Directors of American Properties.

Mr. Cromwell: Just a moment. You have been asked to identify it, not to read from it.

Mr. Short: That is exactly what I expected him to do.

Mr. Cromwell: I thought he was going further, Mr. Short.

Mr. Short: Oh, all right.

Q. (By Mr. Short): What date?

A. August 31, 1949.

Q. And is the signature that purports to be that of S. S. Sayres your signature?

A. That is correct.

Q. And the other signature is whose?

A. Mr. Griffin's, the secretary.

Q. And was there on that date actually a meeting held for that purpose? A. Yes.

(Testimony of Stanley S. Sayres.)

Q. And is that document which you hold in your hand the [34] original minutes of that meeting?

A. Yes, I am sure it is.

Mr. Short: I will offer Petitioner's Exhibit 4.

Mr. Cromwell: No objection.

The Court: It will be received.

(Petitioners' Exhibit Number 4 was received in evidence.)

Q. (By Mr. Short): I had earlier asked you whether or not arrangement or agreement had been arrived at between yourself at any time, between yourself, Ted Jones and Anchor Jensen in reference to the commercial construction of these vessels.

A. There had been a great many discussions.

Q. I hand you what has been marked for identification as Petitioner's Exhibit 1 and I will ask you if you will state what that is.

A. That is an agreement that was signed between American Properties, Ted Jones and myself.

Q. And dated?

A. 17th of July, 1950.

Mr. Cromwell: Who did you state signed this?

The Witness: American Properties, S. S. Sayres as an individual and Ted Jones.

Mr. Cromwell: I have no objection to this except the pencil notation on the first page. [35]

Mr. Short: Well, let me ask him about it.

Q. (By Mr. Short): There appears on the first page of this Petitioner's Exhibit 1 a pencil notation "Unlimited Class", and the pencil nota-

(Testimony of Stanley S. Sayres.)

tion "It was up to 30,000 horsepower". Whose writing is that, "It was up to 30,000 horsepower"?

A. That is mine.

Q. Is it a part of the contract or not?

A. Well, it doesn't affect the contract as I see it. I don't recall now why I put it on.

Mr. Cromwell: When was it put on?

The Witness: I don't know.

Mr. Cromwell: I will agree to the exhibit with the exception of that one pencil notation.

Mr. Short: I think it has no significance.

The Court: It will be ignored, then, the pencil notation.

It will be received.

(Petitioner's Exhibit Number 1 was received in evidence.)

Q. (By Mr. Short): Mr. Sayres, was there any agreement drafted preceding that Exhibit 1?

A. Yes.

Q. That included Anchor Jensen? [36]

A. Yes.

Q. Why was that not signed?

A. Well, a good deal of friction developed between Ted Jones and Anchor Jensen, and it finally reached a point where Ted said he didn't want to be a party in a deal with Anchor.

Q. And that Exhibit 1, then, constitutes a re-draft of that agreement eliminating Jensen?

A. Correct.

Q. One further question. At whose request does S. S. Sayres individually sign that agreement?

(Testimony of Stanley S. Sayres.)

A. That was at Ted's request.

Q. Why?

A. On this particular point, I bound myself on that agreement not to have somebody else build boats for me. The agreement was between American Properties and Jones, but if I hadn't named myself individually——

Mr. Cromwell (interrupting): I object to what the agreement was between, your Honor. It speaks for itself.

Mr. Short: It does not speak for itself, and I am asking the witness to state why, when the title to the vessel and the enterprise is all in a corporation, why an individual binds himself to it.

Mr. Cromwell: I object to that.

The Court: Let him finish.

Mr. Cromwell: Pardon me. [37]

Mr. Short: I am not contradicting the document, I am explaining why S. S. Sayres is an individual signatory to a contract when American Properties at that time owned Slo-mo-shun III and IV.

Mr. Cromwell: That is their assumption, that the corporation owned it. It is not in the record that American Properties owned this boat.

Q. (By Mr. Short): Was there any documentary title on either of the vessels or any of them, I mean, did you ever get a bill of sale or give a bill of sale or any other documentary transfer of either Slo-mo-shun III or IV to American Properties?

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: Just a moment. That is not the best evidence, your Honor. The document itself of the transfer of title would be the best evidence.

Mr. Short: Don't you think we ought to find out if there is one? If there isn't any, this is the best evidence.

The Court: Yes.

Q. (By Mr. Short): Was there any?

A. No.

Q. This boat didn't come to you by document, you built it? A. That is right.

Q. There wasn't any document in existence?

A. Yes.

Q. Other than Exhibit 4, the resolution in evidence, was there any other documentation of the fact that the ownership of the boats was then in the corporation?

A. Well, all the billing for the work as it progressed, and all of those——

Mr. Cromwell (interrupting): I think the question calls for a yes or no answer.

A. Well, yes.

Q. (By Mr. Short): The documentation that you refer to are the books and records of the company and the invoices? A. Yes.

Mr. Cromwell: Just a moment. That is a leading question. I move to strike the answer.

The Court: It was a leading question, as you know. I presume that we must abide by the rules.

Mr. Short: I think he had already answered. I was repeating his answer.

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: I move to strike his answer, then, your Honor.

The Court: I don't know what good that would do. You can rephrase your question. It will be stricken and rephrase your question. [39]

Q. (By Mr. Short): When you say there is some documentary evidence, is it a fact that the title to the boat is in American Properties, will you state what documentation you refer to?

A. Invoices, checks paid out, probably others that I don't recall right now, that would be the mass of the evidence.

The Court: May I ask a question?

Mr. Short: Yes.

The Court: I don't know very much about boats. Do they have to have a license like a car does, automobile?

Mr. Short: Boats ordinarily do not.

Q. (By Mr. Short): Mr. Sayres, how about these boats?

A. A race boat run on any sanctioned regatta has to be registered with the American Motor Boat Association.

Q. If I own a cruiser, I must have some Coast Guard certificate?

A. Yes, and the Coast Guard has some requirement in the last two years, I believe it is, on the registration of a race boat.

Q. Did it at this time? A. No.

Q. By the way, to the extent that there may be confusion about it, this Exhibit 4, being the resolu-

(Testimony of Stanley S. Sayres.)

tion of American Properties of August 31, 1949, is that the date on which your conception of this thing being a profitable venture actually [40] materialized?

A. That is the date on which we said, "Here we go."

Q. All right. Now, bringing you up to the point of time when Exhibit 1 was signed in July of 1950, you had then just the month previous set the record, hadn't you? A. Yes.

Q. With Slo-mo-shun IV? A. Yes.

Q. What, then, transpired between you and Jones and Mr. Jensen and the American Properties in reference to the program to build and sell either the boats or the design of the boats similar to Slo-mo-shun IV, what historically occurred from then on?

A. Well, we, as I say, that agreement was made purely with Jones, Jensen not a party to it.

Q. Yes.

A. We did decide to go ahead and build Slo-mo-shun number V. Now, if I get out of the field that you want me, stop me.

Q. No, that is all right, that is what I want.

A. And I managed to prevail on Jones, or Jones and Jensen, to try and get along while we were building that boat, and Ted Jones worked right out at Jensen Motor Boat Company and helped construct it. That boat was started in, I believe, February of '51, and put in the water late in July.

After that, in the meantime, Jones had ceased

(Testimony of Stanley S. Sayres.)

to work [41] for Boeing Airplane Company, and sometime later after August, I would profess to say the date, he left Seattle and went to work for Kiekhefer.

Q. I think you better spell that one.

A. I hope I can. That is the builder of Mercury Outboard motors. K-i-e-k-h-e-f-e-r is the best guess I can make out of it.

Q. What is your best recollection of that?

A. Sometime late in 1951, but I wouldn't profess to try and pin it down.

Q. All right. Is that the reason the originally conceived idea of producing these boats did not ultimately materialize on a commercial basis?

A. That is correct. He was gone, I heard nothing from him.

Q. Is he now in the business of commercially designing boats?

A. I would say very much so.

Q. How many, off-hand, in limited class hydroplanes are now in existence, give us an estimate, that actually race?

A. Well, you have got to take into account some new boats that have not yet raced, but will this—

Q. (Interrupting) I mean, including them for this question. A. Let's say 20. [42]

Q. How many of them, also estimating, are of the basic Slo-mo-shun design?

A. To the best of my knowledge, all except three boats owned by Horace Dodge and Miss Pepsi

(Testimony of Stanley S. Sayres.)

owned by Dawson Brothers. I think I am correct in that.

Q. Is it fair to state that your prediction that this would be the design universally used was correct?

A. That has been proven entirely true.

Q. By the way, that agreement, Exhibit 1 in evidence, contemplates the payment to Jones of \$5,000 minimum, I believe it was, per vessel. Did he ever get that payment?

A. He received \$5,000 for the design of number V and was also paid for the hourly work that he put in on the construction.

Q. In addition to the \$5,000? A. Correct.

Q. By the way, I overlooked something. The court, sometime ago, inquired as to, regardless of these articles of incorporation of William Motors and the amendment to American Properties, what actually was the function, what was the regular function of American Properties, Inc., prior to August 31, 1949?

A. It owns the, well, we have always called it the main building at Broadway and Madison.

Q. In which the automobile dealership business is maintained, is that right? A. Right. [43]

Q. It is a landlord corporation? A. Yes.

Q. Or was? A. Yes, still is.

Q. Mr. Sayres, would you tell us whether now or in 1949 and '50 racing speed boats was or is your hobby, of these unlimited class hydroplanes, is that a *personally* hobby to you?

(Testimony of Stanley S. Sayres.)

A. Driving the boats, test-hopping, yes, we will call it a hobby, racing the boats—

Mr. Cromwell (interrupting): That answers the question, your Honor.

The Court: I think the witness wants to explain his answer.

A. Proving those boats by competition was the fundamental that would make a business out of them, by winning races.

Q. (By Mr. Short): Like the Gold Cup Races?

A. Correct.

Q. What does test-hopping mean to you?

A. Oh, experimentation, you are trying one propeller, you are trying this and that, steering gears, skid fins, rudders, that is strictly, you might say, an engineering and development project.

Q. What was the prime thing, or your primary motive or purpose in going into the construction of IV and V? [44]

A. I thought there was a business opportunity there.

Q. Was there? A. Yes.

Mr. Short: That is all.

The Court: Let us take a short recess before cross-examination, ten minutes.

(Short recess taken.)

The Court: On the record.

Mr. Cromwell: Your Honor, to save the time of the court, I have about six or eight tax returns here which I am going to ask if counsel for petitioner

(Testimony of Stanley S. Sayres.)

will agree that they will be put in. In other words, have them identified all at one time.

Mr. Short: Are they all one exhibit?

Mr. Cromwell: No, we will make them different exhibits, Mr. Short. Perhaps it would be simpler to have these marked, your Honor, and have the witness identify the signatures.

The Court: Maybe you can stipulate to them.

Mr. Short: Well, the petitioner will make no objection to the identification of the documents, that they are what they purport to be. I question their materiality at this stage of the proceeding.

Mr. Cromwell: I better have these marked and identified.

The Court: I see no reason for that if counsel recognizes [45] that they are competent.

Mr. Cromwell: That is right, they are taxpayer's returns.

The Court: Which taxpayers?

Mr. Cromwell: His individual tax return of Stanley S. Sayres for the tax year ending October 31, 1948, and the individual income tax return of Madeleine A. Sayres for the taxable year ending October 31, 1948, the individual tax return of Stanley S. and Madeleine A. Sayres for the taxable year ending October 31, 1949, the individual income tax return of Stanley S. and Madeleine A. Sayres for the taxable year ending October 31, 1950.

The Court: I will receive them in evidence for whatever relevance they may have, Mr. Short.

Mr. Short: How are they marked?

(Testimony of Stanley S. Sayres.)

The Clerk: They will be marked C, D and E respectively—C, D, E and F respectively.

(Respondent's Exhibits Numbers C, D, E and F were marked for identification and received in evidence.)

Mr. Short: Are they, Mr. Cromwell, in the order that you—Mr. Cromwell, are they marked in the order that you read them to the court?

The Clerk: Yes, respectively as he submitted them.

Mr. Cromwell: I offer Respondent's Exhibit C, which [46] is the income tax return of Stanley S. Sayres for the year ending October 1, 1949.

The Court: They have been received and marked in the order in which you read them off.

Mr. Cromwell: Will you mark these please?

The Clerk: Exhibits G and H for identification.

(Respondent's Exhibits Numbers G and H were marked for identification.)

Mr. Cromwell: I offer Respondent's Exhibit G in evidence, which is the 1949 corporation income tax return of American Properties, Inc.

Mr. Short: No objection.

The Court: It will be received.

(Respondent's Exhibit Number G was received in evidence.)

Mr. Cromwell: I offer in evidence Respondent's Exhibit H, which is the 1950 corporation income tax return of American Properties, Inc.

Mr. Short: No objection.

The Court: It will be received.

(Testimony of Stanley S. Sayres.)

(Respondent's Exhibit Number H was received in evidence.) [47]

Cross Examination

Q. (By Mr. Cromwell): Is it correct, Mr. Sayres, that your position is that the boats, Slo-mo-shun III and IV were transferred by you to American Properties sometime in 1949? A. Yes.

Q. Then would it also be a correct statement, Mr. Sayres, to say that these boats were never transferred back to you? A. Yes.

Q. Was ever a bill of sale given to the corporation for the transfer of these boats? A. No.

Q. In other words, it is your position that at no time since 1949 have you held title to either of these boats? A. That is correct.

Q. Would you also say that is true as to Slo-mo-shun V? A. Yes.

The Court: May I ask a question?

Is that also true with regard to the design or whatever else with regard to it might be of value, or are we talking now about the physical boat?

Mr. Cromwell: The physical boat, your Honor.

Q. (By Mr. Cromwell): Would your answer be the same regarding the physical boats Slo-mo-shun III, Slo-mo-shun IV and Slo-mo-shun V?

A. Yes. That is what I was referring to.

The Court: I don't think I got an answer to my question. [48]

Mr. Short: I think, Mr. Sayres, the court is curious as to other than the physical boat, assume

(Testimony of Stanley S. Sayres.)

the design was patentable for example, that is the kind of thing he refers to, who owns that, does the corporation own that?

The Witness: No, Mr. Jones was the designer, I couldn't control what he might do.

Mr. Cromwell: I think the question was asked by Mr. Short if there was a patent or a copyright on those boats.

Mr. Short: The court asked him that.

The Witness: No patent.

Q. (By Mr. Cromwell): And your answer is there is no patent on those boats?

A. That is right.

The Court: What I am concerned about, if it was just the physical boat that the corporation owns, would it have a right to manufacture other boats of the same design and sell them? I don't know whether they have that right under contract with them or not. I haven't read all the papers here yet. Perhaps that is a matter for argument. It may not be a matter of evidence.

Mr. Cromwell: I think so.

The Clerk: Exhibits I and J marked for identification.

(Respondent's Exhibits Numbers I and J were marked for identification.) [49]

Mr. Cromwell: Respondent offers Respondent's Exhibit I as an exhibit, offers it in evidence, your Honor, which is a certified copy of the county assessor's records, which is a declaration made by Mr. Sayres in 1950 to the office of the county assessor

(Testimony of Stanley S. Sayres.)
of King County, Seattle, Washington, as to the
ownership of this boat and its value, Slo-mo-shun
IV.

Mr. Short: No objection.

The Court: It will be received.

(Respondent's Exhibit Number I was re-
ceived in evidence.)

Mr. Short: Is there a date on there?

Mr. Cromwell: Here it is.

I offer in evidence Respondent's exhibit marked
"J", which is a certified copy of a declaration filed
with the county assessor of King County in 1951
signed by Stanley S. Sayres, declaring that he is
the owner of Slo-mo-shun IV.

Mr. Short: No objection.

The Court: It will be received.

(Respondent's Exhibit Number J was re-
ceived in evidence.)

Q. (By Mr. Cromwell): Mr. Sayres, I show
you Respondent's Exhibit I and ask you if you
signed that declaration?

Mr. Short: I don't hear you, Mr. Cromwell. [50]

Mr. Cromwell: I am showing Mr. Sayres Re-
spondent's Exhibit I and asking him if he signed
the declaration, of which this is a copy.

A. That is my signature.

Q. (By Mr. Cromwell): I hand you Respond-
ent's Exhibit J and ask you if that is your signature
on Exhibit J?

A. That is my signature.

Q. Mr. Sayres, you have stated, I believe, that

(Testimony of Stanley S. Sayres.)

Slo-mo-shun IV won the Gold Cup in Detroit in 1950? A. Yes.

Q. And that Mr. Ted Jones was driving the boat at that time? A. Yes.

Q. Was the expense of running the Gold Cup Race in Detroit in 1950 paid by American Properties?

A. Yes. There was later some other funds came in that didn't directly concern the Gold Cup.

Q. Then, you would say that American Properties paid the expenses of running the Gold Cup Races in 1950? A. Yes.

Q. You did not pay them, is that a correct statement?

A. No, that was charged to American Properties. Now, I can't say that I didn't write a personal check somewhere here and there in the proceeding, but the accounting was all made, [51] and it all went to American Properties.

Q. And would you also say, Mr. Sayres, that all costs of building and developing Slo-mo-shuns IV and V were paid by American Properties?

A. Yes, with that exception, that I make there. Here and there I might have doled out \$50 in cash or written an occasional \$50 personal check which then was charged back.

Q. And would you say that the American Properties also paid all of the expenses of operating Slo-mo-shun IV and Slo-mo-shun V? A. Yes.

Q. From 1949 on?

A. All that were not covered by other sources.

(Testimony of Stanley S. Sayres.)

The Court: Are these cases consolidated?

Mr. Cromwell: I think that is one thing we have neglected to do is to move to consolidate these proceedings.

Mr. Short: Yes.

Mr. Cromwell: For hearing and decision, your Honor.

The Court: All right, they will be consolidated for hearing and decision.

Mr. Cromwell: Will you mark this please?

The Clerk: Exhibit K for identification.

(Respondent's Exhibit Number K was marked for identification.)

The Clerk: And L. [52]

(Respondent's Exhibit Number L was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit K for identification which purports to be a letter on the letterhead of Stanley Sayres, Incorporated, dated August 26, 1953, and referring to the last page of that letter, I ask you if that is your signature. A. That is.

Q. And is that letter addressed to Mr. Paul Alexander of the Rainier District Times, Seattle, Washington? A. Yes.

Q. Did you write that letter, Mr. Sayres?

A. I am sure I did.

Q. You did write that letter, Mr. Sayres?

A. Yes.

Mr. Cromwell: I offer Respondent's Exhibit K in evidence.

(Testimony of Stanley S. Sayres.)

Mr. Short: Your Honor, I will have to read the exhibit, I object to the relevance of the exhibit for any purpose.

The Court: For what purpose is it offered?

Mr. Cromwell: As an admission against interest, your Honor.

Mr. Short: In what respect?

Mr. Cromwell: The statement in here, I am not contending [53] to limit my offer, I am offering the whole letter. Mr. Sayres has testified that the American Properties spent the money to build these boats, Slo-mo-shun boats IV and V, and to race these boats in the Gold Cup, and this letter states to the contrary that those expenses were paid entirely by him.

Mr. Short: Where does it state it?

Mr. Cromwell: I will read this, "I should also know that all the costs of running the 1950 Gold Cup Race in Detroit and the 1951 Gold Cup Race in Seattle were paid entirely by me".

The Court: Mr. Short, I think I will have to receive it on the ground that it tends to be a statement against interest.

Mr. Short: Yes.

The Court: You will have the opportunity to get at it on redirect.

(Respondent's Exhibit Number K was received in evidence.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit L marked for identifica-

(Testimony of Stanley S. Sayres.)

tion, which is a letter addressed to Paul A. Alexander, the Rainer District Times, Seattle, Washington, dated September 21, 1953. Turning to page three of that letter, I ask you if that is your signature. A. Yes, that is the same one.

Q. No, it is not.

A. That is my signature. [54]

Q. This is your signature, Mr. Sayres?

A. Yes.

Q. And did you write this letter, Mr. Sayres?

A. Yes.

Mr. Cromwell: I offer in evidence Respondent's Exhibit L, which is the letter of Stanley Sayres dated September 21, 1953, to Mr. Paul J. Alexander, Rainer District Times.

Mr. Short: I have obviously the same objection because it is a redraft of the same letter, is it not, counsel?

Mr. Cromwell: No, it is not. This is a different letter.

Mr. Short: Same objection, and particularly to the volunteer underlining in red of certain words that have not been identified.

Mr. Cromwell: The underlining in red, Mr. Short, was not done by the government. That was in the letter.

The Court: Is it necessary for me to read this one? Does counsel agree that it is in general like the other letter?

Mr. Short: Yes, it would serve no purpose to read it again.

(Testimony of Stanley S. Sayres.)

The Court: I will admit it as I did the other one, with opportunity for you on redirect to explain the letter.

(Respondent's Exhibit Number L was received in evidence.)

Mr. Cromwell: Will you mark this please? [55]

(Respondent's Exhibit Number M was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit M marked for identification, which purports to be a copy of the Rainer District Times dated Thursday, August 20, 1953, and I refer you to an editorial there by Mr. Paul J. Alexander, and ask you if you read that editorial.

A. Yes.

Q. You have seen that? A. Yes.

Q. Would you state that was what precipitated these letters just put in evidence?

A. Yes, correct.

Q. To Mr. Alexander? A. That is correct.

Mr. Cromwell: I offer Respondent's Exhibit M in evidence, your Honor.

Mr. Short: Well, I will object to the editorial, having read the first of these letters in response to this editorial, the thing was claimed to be libelous. It affects no issue in the matter before the court. It protests the littering of Lake Washington as a result of Gold Cup Races, and that this witness is the culprit. There is no reference to these expenses paid by either the corporation or Mr. Sayres.

Mr. Cromwell: Your Honor, it is offered simply

(Testimony of Stanley S. Sayres.)

to tie it in with the letter. Mr. Sayres has stated it was what caused him to write the letters, this editorial. It is not offered as evidence of the facts therein stated.

Mr. Short: I may add that it is an attempt to add to the government's case because of the fact the views of Mr. Alexander coincided with those of the government that this is a wealthy industrial-playboy. That is the purpose of the offer, and that is all that appears in the editorial.

Mr. Cromwell: The purpose of the offer, your Honor, is just to show the occasion for these letters.

Mr. Short: What purpose is served by proving the occasion? The purpose of the letter is a statement against interest, proving the occasion for the letter is simply inflammatory.

The Court: I don't think we ought to have this in evidence, Mr. Cromwell.

Mr. Cromwell: Your Honor, I don't see how you can understand those letters unless you have this to tie them in. It is not offered as any fact.

The Court: The only thing the letters are in for is to show certain statements made by the petitioner here that he stood the expenses of large amounts. I don't know that——

Mr. Cromwell (interrupting): Those letters, your Honor, are offered for all purposes, they are not limited to [57] that.

Mr. Short: They only have one valid purpose and that is the one I inquired about.

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: Respondent has offered them for all purposes, and I believe the court has received them as general statements.

Mr. Short: They are objectionable for all purposes, they are admissible for one, the statement against interest.

The Court: I don't think they are admissible for any purpose except the admission against interest.

Mr. Cromwell: That is right, but the entire letter is offered.

The Court: Is there anything else in those letters other than the statement about paying personally these expenses of the races and the boat?

Mr. Cromwell: And the matters as he personally stated here, "Now to get a few more facts on the record: One, I have personally spent more than \$100,000 in building and developing the Slo-mo-shuns—" I will skip two, I will skip down to four, "No tax advisor has yet been able to tell me how to deduct these very substantial sums from either business or personal income taxes".

Now, that is certainly relevant, your Honor.

Mr. Short: Those are the two remarks in the entire four-page letter which have any relevance here. [58]

Mr. Cromwell: Your Honor, Number seven also states, "Your reference to 'well-to-do' seems sarcastic. I have had some reasonable degree of success in 35 years in business. I do not, however, have so much money that I can personally afford to finance

(Testimony of Stanley S. Sayres.)

Seattle's greatest show to the tune of thirty to thirty-five thousand dollars per year".

Mr. Short: That is not a statement of any relevance to this proceeding. It is not against interest.

The Court: Can't counsel stipulate that those letters were written in answer to an editorial in the paper?

Mr. Short: I may——

The Court (interrupting): You might even state in substance what this is.

Mr. Short: I will stipulate that Exhibit K and L are written in response to that editorial, but the editorial itself has no bearing.

The Court: I don't see how this has any evidential value, this paper itself. As you say, it only explains why this man wrote the letters. Why couldn't you simply stipulate to this, that they were written in answer to an editorial criticizing—well, whatever the substance of that is?

Mr. Short: I reserve my objection to the editorial.

Mr. Cromwell: I would like to make an offer of proof on this editorial, read it in the record.

Respondent's Exhibit marked "M" for identification, if [59] received, would show that in the Rainer District Times dated Thursday, August 20, 1953, on the left-hand far extreme side of the first page under an editorial entitled "Our Opinion" by Paul J. Alexander, I quote from that:

"Tears as large as grapefruit rolled down our cheeks last Sunday morning when we read of the

(Testimony of Stanley S. Sayres.)

appeal for help to raise \$37,500 to aid a well-to-do automobile distributor in this city to carry on his favorite, rather expensive hobby, of racing unlimited hydroplanes. If we recollect correctly, there was some \$45,000 raised last year to send these hydroplanes back to race for the Harmsworth Trophy. They never went. We thought of the thousands of dollars it has cost the taxpayers already to prepare for and clean up the mess which attended the recent hobby show on the shores of Lake Washington. With so much money need for worthy causes such as the fight against cancer, heart disease, cerebral palsy and the forthcoming Good Neighbors Drive, we see the public fund raising for pet racing hobbies as a little far-fetched. Sometime ago it was suggested that members of civic boards such as the Park Planning, Library and School Boards be reimbursed for their expenses in connection with the giving of their time and energies for the good of the community. Our mayor vetoed this idea orally declaring that the honor was sufficient recompense for the work, thought and expense involved. Now it seems to us that if a public collection is to be taken up it should go adding to the funds necessary to [60] provide our departments help to clean up the messes incident to the carrying on of the combination, advertising hobby of our well-to-do citizens.

Seems that we can recall quite a fuss raised by some members of the City Council a year ago when S. L. Savage, an automobile dealer, wanted to

(Testimony of Stanley S. Sayres.)

donate a pair of giraffes to our city. These he had captured at his own expense and the beef was about providing housing for them. Our big brother, TPI, would do well to stick by such fine promotions as they have sponsored for the past several years, such as teaching our youngsters how to swim, aiding the music under the stars, and other like splendid civic contributions. Every time they come up with something that has to do with the Gold Cup Races they raise the eyebrows of those who like our Seward Park unscalped and our beaches free of beer cans, milk bottles, watermelon rinds and other debris.”

The Court: Very well, the objection is sustained. I think that just newspaper articles or editorials are not competent proof in this case.

(Respondent's Exhibit Number M was rejected.)

Q. (By Mr. Cromwell): Mr. Sayres, when did you become the principal stockholder of American Automobile Company?

A. January—oh, principal, I believe in '37. [61]

Q. How many shares of stock do you hold, or did you acquire, at that time?

A. I don't recall the number of shares. I had one major partner, Mr. Luke Wood, I bought him out, I believe it was in the, oh, late in '37, and I bought whatever he had outside of a qualifying share or two.

Q. What has been the business of American Properties since it was incorporated—pardon me, American Automobile Company?

(Testimony of Stanley S. Sayres.)

A. Merchandising motor cars and parts.

Q. What type of automobiles?

A. Chrysler-Plymouth.

Q. Do you consider that it was a retail distributor or just what?

A. Well, we were a distributor in the full sense of the word from '32 through, I believe it was '47, and then the Chrysler corporation wiped out all distribution and we became a direct dealer.

Q. That is in King County?

A. They wiped it out from one end of this country to the other. We became just one of other Chrysler dealers in King County.

Q. In King County in which Seattle is located?

A. Right.

Q. Do you know how many others during the years 1949 and 1950, how many other Chrysler dealers there were? [62]

A. Well, I hesitate to make a flat statement. I think there were six in the county and I think there were two others within the city limits, and one on Mercer Island. I am not flatly positive of that county, the numbers change now and then.

Q. Who owns the building occupied by the American Automobile Company?

A. American Properties.

Q. And do you also own American Properties Corporation? A. Yes.

Q. You are the sole stockholder, is that correct, other than qualifying shares?

A. No, Mr. Griffin is a qualifying stockholder.

(Testimony of Stanley S. Sayres.)

Q. Pardon?

A. I say, Mr. Griffin is a qualifying stockholder, I think, is that not correct, Tracy?

Q. How many shares does Mr. Griffin hold?

A. I hesitate to say.

Mr. Griffin: One, to my recollection.

A. Well, that is my recollection.

Q. (By Mr. Cromwell): Are there any other qualifying shares? A. No.

Q. Now, who owned the American Properties building prior to 1949, Mr. Sayres, was that always, has that been owned for some number of years by American Properties, how many years has [63] American Properties owned the building occupied by American Automobile Company?

A. I believe since 1933, but I am not absolutely certain of that date. That goes back a good many years.

Q. Where is that building located, Mr. Sayres?

A. Broadway and Madison.

Q. How far from a navigable body of water, would you say, that building is in terms of miles?

A. Well, I would say about three miles.

Q. About three miles from the nearest body of water?

Mr. Griffin: If I may make a little correction, he is thinking about Lake Washington where these run, not the Sound.

The Witness: I was thinking in terms of Lake Washington, I think if you drive right out Madison

(Testimony of Stanley S. Sayres.)

Street from our corner to Lake Washington, it is about three miles.

Mr. Griffin: He said navigable water. Puget Sound is the most navigable water in this part of the world——

Q. (By Mr. Cromwell, interrupting): How far is it from Elliott Bay to the building owned by American Properties, Mr. Sayres?

A. I would say between a mile and a half to two. I don't guarantee the accuracy of that.

Q. Where were the Slo-mo-shun IV and V and also the Slo-mo-shun III housed during 1949 and 1950? [64]

A. The bulk of the time at my residence, but part of the time at Jensen Motor Boat Company.

Q. Do you have a boathouse at your residence?

A. Yes, yes.

Q. Where is your residence, Mr. Sayres?

A. 4450 Huntspoint Road.

Q. Huntspoint Road, is that on Lake Washington? A. Yes.

Q. Will you describe Huntspoint to the court, please, just what it is, its location and what it is?

A. Well, Huntspoint is the tip of a point of land that projects out into the lake.

Q. Is that an exclusive residential district, Mr. Sayres? A. That is open to opinion.

The Court: Maybe the question should be, exclusively a residential area.

The Witness: Yes, it is that, that is, within the immediate area there.

(Testimony of Stanley S. Sayres.)

Q. (By Mr. Cromwell): How far away from the boathouse or your property on Huntspoint is Anchor Jensen's boat building company, would you say, in terms of miles?

A. By land miles it is probably 15, by water it is probably 5.

Q. You, I believe, stated on direct that Slo-mo-shun III [65] was built at Anchor Jensen's, is that correct?

A. Yes, the construction of that boat was started by Mr. Jones out at his house, and then this time didn't permit him what he needed, and it was moved on over to Jensen's and completed there.

Q. What stage of completion was it when it was moved to Mr. Jensen's?

A. I would hesitate to say, perhaps—well, that is a hard question to answer. I might say half, but it is not necessarily correct.

Q. Were Slo-mo-shun IV and V built at Anchor Jensen's, too? A. Yes.

Q. Mr. Sayres, you referred on direct examination to certain technicians that assisted you subsequent to 1949, '49 or subsequent to that year, in preparing these boats and running them in the Gold Cup Races and so forth. I believe you named Mike Welsh, is that correct, as being one of them?

A. Yes.

Q. Who did he work for?

A. He did, and still is, with the Boeing Airplane Company.

Q. Was he a full-time employee with Boeing?

(Testimony of Stanley S. Sayres.)

A. Oh, yes.

Q. At that time? [66] A. Yes.

Q. Who is Elmer Linden Smith?

A. Elmer at that time was with Sunday DeVare, this marine supply company.

Q. Was he a full-time employee at that time with Sunday DeVare? A. Yes.

Q. Now, Ted Jones, who was he employed by at that time?

A. Well, if we talk about—I can't tell you the date that Ted was working for Boeing Airplane Company, when I first got acquainted with him, and all these first endeavors were made. Ted left Boeing, he would have to tell you, but sometime in '51 I believe, the early part, but otherwise he was a fulltime employee of Boeing.

Q. In between times he worked for you in designing and building the boats?

A. His work for me was done nights, weekends and holidays.

Q. Was he ever employed by American Properties, Inc.?

A. Yes, he was, during the period that number V was being built.

Q. You stated that Western Gear Works built the gear boxes for the Slo-mo-shun IV and Slo-mo-shun V? A. Yes.

Q. Did Western Gear Works have any connection with American Properties? [67]

A. Well, no connection.

Q. No business connection?

(Testimony of Stanley S. Sayres.)

A. No, I went to Western Gear to begin with and asked them if they would design and build this first gear box. As a matter of fact, Mr. Scott is the man that arranged with the man for me to see.

Q. Is the gear box an important part of those boats? A. Tremendously, yes, very vital.

Q. You mentioned that Lou Fageol drove these boats in 1951 in the Gold Cup, I believe?

A. Yes.

Q. Is Mr. Fageol, do you know him to be a wealthy sportsman?

A. He is considered to be wealthy.

Q. And now, Stanley Dollar also drove the boats, Slo-mo-shun IV, did you say, in 1952?

A. Dollar won with number IV in '52, correct.

Q. And is he also a wealthy man?

A. I believe so.

Q. Is he of the Stanley Dollar Steamship Lines?

A. Yes.

Q. And Joe Taggart has driven the boats in several Gold Cup Races? A. Yes.

Q. What kind of engines does the Slo-mo-shun IV have in [68] it, Mr. Sayres?

A. Well, in the early years we used Ellison engines, last year we had a Packard-built Merlin engine.

Q. And Slo-mo-shun V, what type of engine did that boat have?

A. V originally had Ellison, and then we went over to the Merlin engine. We first tried the Merlin in '53 in the V.

(Testimony of Stanley S. Sayres.)

Q. Who builds the Ellison engine?

A. Well, it is the Ellison Division of General Motors, Indianapolis. These were all surplus World War II engines.

Q. Who builds the Rolls Royce Merlin engine?

A. Packard Motor Car Company.

Q. When did you set the now world speed record for the first time?

A. June 26, 1950.

Q. And you were driving the boat at that time?

A. Yes.

Q. Did you get a trophy for that?

A. No, I got a diploma, piece of paper.

Q. Were you driving the Slo-mo-shun IV when the Harmsworth Trophy was won?

A. No, Fageol was driving it.

Q. How many times have you won the Gold Cup since the first race in 1950 that I understand you won?

A. Well, I didn't win it at all personally, but the [69] boats won four successive Gold Cups.

Q. Does your name appear on the Gold Cup as the winner?

A. Oh, I suppose it does. I haven't looked at the Gold Cup for a long time.

Q. Were you registered with the American Power Boat Association as the owner, you, Stanley Sayres, in 1950?

A. Yes—I might as well explain that. APBA rules provide that a corporation can't enter a boat.

(Testimony of Stanley S. Sayres.)

It must be entered in any sanctioned regatta by any member of a——

Q. (Interrupting): Just a minute. Answer my question.

Mr. Short: I think he is entitled to an explanation.

Mr. Cromwell: I have no way to check the rules here.

Mr. Short: Then you shouldn't have asked the question. I think he is entitled to fully explain why he is the winner.

The Court: Wouldn't you care to bring that out yourself by questioning him on redirect?

Mr. Short: I don't want it distorted to direct either. I will bring it out.

Q. (By Mr. Cromwell): Mr. Sayres, were you registered with the American Power Boat Association as the owner of Slo-mo-shun IV in 1950?

A. Yes.

Q. Were you registered as the owner of Slo-mo-shun V in 1951? A. Yes. [70]

Q. With the American Power Boat Association?

A. Yes.

Q. Have you always been registered as the owner of Slo-mo-shun IV and Slo-mo-shun V with the American Power Boat Association?

A. Yes.

Q. You stated on direct examination that Slo-mo-shun IV is a two-place boat, is that correct, Mr. Sayres? A. Yes.

Q. That is, two seats, one for the driver and one

(Testimony of Stanley S. Sayres.)

for the mechanic? A. Correct.

Q. And Slo-mo-shun V is a one-place boat?

A. Yes.

Q. What value did you feel these boats would have to the Navy inasmuch as they were one- or two-place boats?

A. Well, certainly you could use the same basic design and build a seventy or eighty-foot boat and perhaps, in our theory, at least, travel a lot faster than any PT boat ever thought of going, as you made the boat bigger you certainly would not be limited to one passenger.

Q. Did you ever build a boat like that, seventy or eighty feet? A. No.

The Court: How much longer did you think cross examination [71] will last?

Mr. Cromwell: About an hour, your Honor, or so.

The Court: This is the usual lunch hour, I think we should adjourn until 2 o'clock for lunch.

(Whereupon, at 12:35 o'clock p.m., the hearing was adjourned until 2 o'clock p.m.) [72]

Afternoon Session

The Court: On the record.

STANLEY S. SAYRES

resumed the stand and testified further as follows:

Cross Examination—(Continued)

Q. (By Mr. Cromwell): Mr. Sayres, were you ever made, appointed, man of the year?

(Testimony of Stanley S. Sayres.)

A. Yes, 1950.

Q. In Seattle? A. Right.

Q. What is that award?

A. Well, that award was originated, to the best of my knowledge, by Brougham and the Seattle P.I.

Q. And what is the award for?

A. Oh, achievement in the sports field.

Q. What other trophies have you won in your racing of speed boats, that is, since 1949?

A. Well, the Gold Cup, the Harmsworth, which, of course, are not my trophies, they are in my possession as long as I hold them, and at one time and another we have won the Martini Rossi Trophy, which was for the fastest heat, I believe in the Gold Cup Race, and there is an Aaron LeRoy plaque for the fastest over-all race average. That is the extent.

Q. Do you personally keep those in your home?

A. No, they stay at the Seattle Yacht Club.

Q. Were you a member of the Seattle Yacht Club in 1949? A. Yes.

Q. And the years subsequent to that?

A. Yes.

Q. Did you hold any job, that is, were you an officer of the Seattle Yacht Club in those years?

A. Well, not right at that time. I was on the Board of Directors for three years, I think somewhat subsequent to '51 or along in there.

Q. Did you personally pay the dues to belong to the Seattle Yacht Club?

A. That I can't say. They may have been paid

(Testimony of Stanley S. Sayres.)

by American Properties or American Automobile Company. I was a member of the Yacht Club for many years before I had a race boat, or that is, the unlimited boats.

Q. Do you subscribe to the Post Intelligencer?

A. Yes.

Q. How long have you subscribed to the Post Intelligencer?

A. Oh, as nearly as I recall, since I have been in Seattle.

Q. That is a daily newspaper? A. Yes.

Q. Have you been personally acquainted with Royal Brougham? [74] A. Yes.

Q. And also Cliff Harrison? A. Yes.

Q. How long have you been personally acquainted with those two men?

A. Oh, I had probably met them long before the race boats became prominent, but I really didn't get acquainted until after that.

Q. Have you granted each of these gentlemen interviews, personal interviews, over the years since you have won the Gold Cup? A. Yes.

Q. Numerous interviews?

A. I would say quite numerous in Mr. Harrison's case, and occasionally with Mr. Brougham.

Q. Do you keep a scrapbook of newspaper and magazine articles respecting the Slo-mo-shuns?

A. Yes, although that has gotten completely out of control, the scrapbook material is stuffed in closets and drawers, it got beyond the scope of putting it together.

(Testimony of Stanley S. Sayres.)

Q. You are pretty familiar, then, with the articles that have been written respecting your boats?

A. Certainly. I have read many of them, and often I am surprised to find one now and then that I have never seen before in my life. [75]

Q. Isn't it a fact, Mr. Sayres, that these articles generally referred to you as the owner of Slo-mo-shuns?

Mr. Short: Objected to as immaterial.

The Court: I will let it in for whatever materiality it may have. It may not be material.

A. Well, certainly in many cases they do.

Q. (By Mr. Cromwell): Refer to you as the owner? A. Yes.

Q. Have you ever tried to correct those statements?

A. Yes, I have tried, but not too successfully.

Q. How have you tried to correct those statements?

A. Well, I have just said that actually the boats are owned by American Properties. On the other hand, I can't, or didn't, feel at least, that I could ask Cliff Harrison, as an example, or Brougham, to please write an elaborate explanation each time he referred to me or the boats, of the technicalities of the ownership. I gave up.

Q. Then this matter of ownership is a mere technicality, then, isn't it, Mr. Sayres?

A. What?

Q. Then the matter of ownership is a mere technicality?

(Testimony of Stanley S. Sayres.)

A. No, I don't regard it as a technicality at all, but in stating myself or being quoted in the press or asked questions on the street corner, yes. [76]

Q. Yes, what, Mr. Sayres?

A. It is a technicality, then.

Mr. Cromwell: Will you mark this, please.

The Clerk: Exhibit "N" for identification.

(Respondent's Exhibit N was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit N marked for identification, which is a copy of the Seattle Post Intelligencer, dated Sunday, June 15, 1952, page 31, and I refer you to the article entitled, "One Slo-Mo out, Stan Sayres says", under the by-line of Cliff Harrison. I refer you also to the quote in that article, and ask you if you stated that to Mr. Harrison?

A. I couldn't testify that that is an exact quotation, but I would not deny that I perhaps referred to the whole thing, the race boat business, as a hobby, many times.

Q. Then you would state that in substance that is a correct quote as quoted by Mr. Harrison?

A. That could be.

Q. Is it or is it not, Mr. Sayres?

A. I don't know. A writer comes up and asks me a series of questions and takes some notes and then goes back and writes the article and sometimes they are put in quotes. Now, I do not deny at all that I may have said, "this hobby" thing. I have [77] said it other times, but whether that is an

(Testimony of Stanley S. Sayres.)

exact word-for-word quotation of what I said, I don't know.

Q. In substance you would say it was a correct quotation? A. I would say it could be.

Mr. Cromwell: I offer Respondent's Exhibit N in evidence.

Mr. Short: No objection.

The Court: It will be received.

(Respondent's Exhibit N was received in evidence).

Mr. Cromwell: Will you mark this, please.

The Clerk: Respondent's Exhibit O for identification.

(Respondent's Exhibit O was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit O for identification, which is a copy of pages 1 and 12 of the Seattle Post Intelligencer newspaper, dated Sunday, June 29, 1952, and I refer you to an article on page 1 of this exhibit entitled, "Seattle Given Chance to Aid Slo-Mo-Shuns", under the by-line of Cliff Harrison. Referring to a continuation of that article on page 12 of Respondent's Exhibit O marked for identification, I ask you to read these quoted quotations and ask you if you made those quotations?

A. I would say those were substantially correct.

Mr. Cromwell: I offer Respondent's Exhibit O in evidence.

Mr. Short: No objection.

The Court: It will be received.

(Testimony of Stanley S. Sayres.)

(Respondent's Exhibit O was received in evidence.)

Mr. Cromwell: Will you mark this, please.

The Clerk: Exhibit P for identification.

(Respondent's Exhibit P was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit P marked for identification, which is a copy of page 18 of the Seattle Post Intelligencer newspaper, dated May 11, 1952. And I refer you to this picture here and also this picture, and ask you if that is a picture of your boathouse?

A. That is right.

Q. At your Hunt's Point property?

A. Yes.

Q. And is this a picture of your home?

A. Right.

Q. The same location? A. Yes.

Q. Will you read that, please?

Mr. Short: Just a moment. We have been furnished copies [79] of previous articles. This is new to me and I don't think it should be read in the record until displayed to counsel and otherwise identified.

The Court: You didn't mean to read it aloud, did you?

Mr. Cromwell: Not to read it aloud, Mr. Short.

Mr. Short: Oh.

Q. (By Mr. Cromwell): Is that a description of your boathouse and your home, Mr. Sayres?

A. Well, I think it is. Frankly I don't follow

(Testimony of Stanley S. Sayres.)

the society pages too closely, and I don't try to edit those word for word.

Q. But you would say that is a reasonable description of your home and boathouse?

A. The boathouse and the house, yes.

Mr. Cromwell: I offer Respondent's Exhibit P in evidence.

Mr. Short: Why? I object to this as being utterly irrelevant. This is Mr. Sayres' home.

Mr. Cromwell: It is also a picture of the boat-house where the Slo-Mos are kept, and this is merely corroborative of the testimony.

Mr. Short: It is an attempt to prejudice the witness.

The Court: I take it to be admissible in connection with the statement that the boat was kept at his house or in the [80] boathouse near his house. I would receive it for one purpose only, of showing the boathouse where the boat is kept.

Mr. Short: May I renew my objection and add that, of course, the boat has to be kept on the water. The man lived at the time of that article in 1952, on the water. During the taxable years involved he did not live at the residence portrayed in that photograph. It is irrelevant to any issue in 1949.

Mr. Cromwell: He testified right along all the way up to 1956 about these boats, and he opened the entire thing up as to that, and he has also testified on cross examination that he kept these boats at this particular boathouse.

The Court: During what years?

(Testimony of Stanley S. Sayres.)

Mr. Short: That is the question.

Mr. Cromwell: Well, the years were not identified.

Mr. Short: Why don't you ask him where he lived in 1949?

The Court: What are the years in question here?

Mr. Cromwell: 1949 and 1950, your Honor. However, in a case of this nature involving a hobby, claim of a hobby and so forth, the substantive evidence is very relevant.

The Court: The substantive evidence may have some value. I will receive it for that one limited purpose of showing the place where the boat has been kept.

(Respondent's Exhibit P was received in evidence.) [81]

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit H, which is the corporation income tax return of American Properties for the year 1950. Referring to page 3 of that return, Schedule "K" listing other deductions, we have a figure, there is a figure in red called "Expense contributions (travel, et cetera, \$6,912.15). Will you state what that represents?

A. Well, I assume that is the amount paid by Greater Seattle to defray part of my 1950 expenses.

Q. Of operating the Slo-Mo-Shun IV?

A. Right, yes.

Q. Was that amount of money paid to you or to American Properties?

A. Well, the money went to American Proper-

(Testimony of Stanley S. Sayres.)

ties, I can't tell you offhand whether the check was originally made to me and then deposited to American Properties by me or not. American Properties was the final recipient.

Q. What is Greater Seattle, Mr. Sayres?

A. Well, that is an organization that was promoting the annual Sea Fair and numerous other events during the year. The general aim, I think, is to put Seattle on the map in one fashion or another. As you know, they have sponsored not only boat races, but football games and the Aqua Follies and many, many events, all the way through the year.

Q. Is Greater Seattle a profit-making corporation? [82] A. I think not.

Q. How does it raise its funds?

A. Memberships, public subscriptions.

Q. Will you tell us why it is that Greater Seattle made this contribution to American Properties, Inc., in 1950, or to yourself?

A. They thought that the bringing of the Gold Cup Race by virtue of my winning it might be a very desirable thing for Seattle to have in the way of bringing crowds of people here and nation-wide publicity for Seattle.

Q. Did you appeal to Greater Seattle for this contribution? A. No, I would say not.

Q. It was voluntary you would say?

A. Yes.

Q. Did you ever receive any more contributions from Greater Seattle to operate the Slo-Mo-Shun

(Testimony of Stanley S. Sayres.)

boats? A. Subsequent to this?

Q. Subsequent to this. A. Yes.

Q. What were those amounts, do you recall?

A. No, I hesitate to name them.

Mr. Short: I object to getting out of the years '49 and '50 on this issue.

Mr. Cromwell: Your Honor, they have gotten out of the years continuously on direct examination. They have carried [83] it right on through, Mr. Sayres testified that Slo-Mo-Shun V wasn't built until 1951. Now, that is certainly outside of our taxable year.

Mr. Short: There should be some relevancy to getting out of the taxable year.

Mr. Cromwell: He also testified who won the races in '52, '53 and '54 and they won the Gold Cup in subsequent years.

The Court: I think that is true, and I don't know just what bearing it may have, but I think the cross-examination can pursue it to the extent that the direct examination did, if you think it is material to your case.

Q. (By Mr. Cromwell): Did Greater Seattle ever sponsor any campaigns to raise money for you to operate these boats, Mr. Sayres? A. Yes.

Q. Did they advise the public that the American Properties, Inc., owned these boats?

A. I don't think so.

Q. Did they hold you out as the owner of the boats?

(Testimony of Stanley S. Sayres.)

A. I can't answer that flatly, I would assume, yes.

Mr. Cromwell: Will you mark this.

The Clerk: Exhibits "Q", "R", "S", "T" and "U" for identification.

(Respondent's Exhibits Q, R, S, T & U were marked for identification.) [84]

Q. (By Mr. Cromwell): I hand you Respondent's Exhibit Q marked for identification, and ask you if you—which purports to be Sea Fair Regatta official program dated August 2-12, 1951, published by Greater Seattle, Inc., and I ask you if you ever saw that? A. Oh, yes.

Q. Referring to page 3 of this exhibit, marked for identification, I refer you to that (indicating) statement. Did you ever see that before?

A. Oh, yes, I have seen that.

Q. This statement as to "Owner, Stanley Sayres"? A. Yes.

Q. Referring to page 11 of Exhibit Q marked for identification, I refer you to the column headed, "Summary of American Power Boat Association Gold Cup Races", and under the column, "Owner, Stanley S. Sayres"? A. Yes.

Q. Had you seen that? A. Yes.

Mr. Cromwell: Your Honor, Respondent offers Exhibit Q marked for identification, in evidence.

Mr. Short: I can't see the materiality of the exhibit itself.

The Court: Do you object to the competency?

Mr. Cromwell: I think I can tie it up, your Honor. [85]

(Testimony of Stanley S. Sayres.)

Mr. Short: In view of his testimony I see no relevancy to the magazine itself, no competency.

Mr. Cromwell: Your Honor, these ownerships can be shown by tacit admissions, admissions by silence, and there are certain admissions in these, that is, certain statements as to "owner, Stanley S. Sayres".

The Court: Is this some sort of an official magazine?

Mr. Cromwell: That is the official regatta program.

Mr. Short: I take it counsel has no law to prove that silence proves something.

The Court: On what?

Mr. Short: He indicated that title can be shown by silence. I think that is getting a little bit far-fetched.

Mr. Cromwell: That goes to indicate, a tacit admission, your Honor, the failure to deny an official program put out, stating that Mr. Sayres is the owner.

The Court: Well, the Court is concerned with what the actual facts are as to ownership, of course. As I have indicated before mere statements in newspapers and such I don't consider competent evidence. But this may be in a different category if this is the official regatta program as it appears to be, I think it is admissible for the purpose of showing that it was entered in the regatta and you may, Mr. Short, show on redirect, whether that has any bearing upon the true ownership.

(Testimony of Stanley S. Sayres.)

Mr. Short: We are perfectly willing to stipulate that [86] in all entries.

Mr. Griffin: All entries were put in by the individual and not by the corporation.

The Court: Is there any need for cluttering up the record then of any program of this sort, if it can be stipulated it was entered in as owner by this petitioner?

Mr. Cromwell: Your Honor, I would like to have the official programs in evidence.

The Court: Is there any other purpose in putting them in than to show that fact?

Mr. Cromwell: Well, yes, your Honor. It shows that Mr. Sayres was held out by Greater Seattle who contributed, admittedly, to the operation of these boats, they held him out as the owner of the boats.

Mr. Griffin: He has so conceded in his testimony.

Mr. Cromwell: And he never denied it, public subscriptions were made to promote these boats of Mr. Sayres'.

The Court: Can't that be conceded between the parties?

Mr. Griffin: It is.

The Court: Let us make a statement of some sort for the record to which the parties can agree and not put too much of this in the record. Who puts out this magazine?

Mr. Cromwell: Your Honor, Greater Seattle, Inc., it states right on the cover.

The Court: Do I understand that Greater Seat-

(Testimony of Stanley S. Sayres.)

tle, Inc., [87] did get public contributions on the basis of representing——

Mr. Cromwell (interrupting): On the basis of representing Mr. Sayres to be the owner of the Slo-Mo-Shun boats.

The Court: Well does this prove that?

Mr. Cromwell: This shows that, yes, it is the official program, your Honor, published by Greater Seattle, that isn't denied, is that correct, Mr. Short, these are the official programs?

Mr. Short: I haven't even seen it, I wouldn't know if I looked at it and that is why I didn't look at it. I have no office with Greater Seattle. I wouldn't know their program.

Mr. Cromwell: Mr. Sayres has identified it.

Mr. Short: I know he has, and he says that they hold him out as the owner. This isn't left to proof. You are cluttering the record.

Mr. Cromwell: I would like for it to go in the record, your Honor, and the Court may give it whatever weight it sees fit.

Mr. Short: It is incompetent to establish anything that isn't already admitted.

The Court: It is incompetent to prove anything except that in the Regatta it was represented that this petitioner was the owner of the boat so far as I know now. If you insist I will receive it for that purpose.

Mr. Cromwell: That is the basis of our offer, your [88] Honor.

(Testimony of Stanley S. Sayres.)

(Respondent's Exhibit Q was received in evidence.)

Mr. Cromwell: I also have the same thing for 1952, 1953, 1955 and 1955. 1952, Respondent's Exhibit R, is offered for the same purpose.

The Court: Well, I will receive them for that purpose only and not as proof of any facts contained in these magazines.

Mr. Short: May our objection run to all of them?

The Court: It may.

(Respondent's Exhibit R was received in evidence.)

Mr. Cromwell: I offer Respondent's Exhibit S in evidence, which is the official Sea Fair Program published by Greater Seattle, Inc.

Mr. Short: Same objection.

(Respondent's Exhibit S was received in evidence.)

Mr. Cromwell: I offer Respondent's Exhibit T in evidence, which is the official Sea Fair program published by Greater Seattle.

Mr. Short: Same objection.

The Court: It is received.

(Respondent's Exhibit T was received in evidence.) [89]

Mr. Cromwell: I offer in evidence Respondent's Exhibit U, which is Greater Seattle's official Regatta program for the year 1955.

Mr. Short: Same objection.

The Court: The objection is overruled. It will

(Testimony of Stanley S. Sayres.)

be received for that limited purpose that I indicated above.

(Respondent's Exhibit U was received in evidence.)

Q. (By Mr. Cromwell): Mr. Sayres, did you ever make any effort to have these statements corrected in these official programs as to your ownership?

A. I can't make any effort to have a statement corrected under the A.P.B. rules when they state me as owner.

Q. Just a moment. Will you answer that yes or no, have you ever made any effort to have those statements corrected in those official records?

A. No. After they are published I can't do anything.

Q. Did you ever have any opportunities to sell Slo-Mo-Shun IV, Mr. Sayres?

A. Second-handed, yes, not directly to me. That is, frankly, Mr. Jones told me at one time that Mr. Horace Dodge wanted to buy it.

Q. Did you refuse to sell it?

A. No, I won't say that I refused, but I wanted somebody [90] to talk directly to me about it.

Q. Did you try to talk directly to Mrs. Dodge?

A. No.

Q. Weren't you interested in making a profit on the sale?

A. Had I had a bona fide offer——

Q. (Interrupting) Yes or no, Mr. Sayres.

(Testimony of Stanley S. Sayres.)

Mr. Short: I don't think that is a yes or no question.

The Court: He can give a yes or no answer and then explain it. What was the question?

(Second preceding question read.)

A. I would say no, because had I sold it in 1950 that would have probably ended any hopes I had of going on with the development, continuing development and getting into the boat business. It could have. That is a question that nobody can answer flatly. And I am quite sure had I had a large enough bona fide offer, I would have probably taken it.

Q. Couldn't you have built another boat just like Slo-Mo-Shun IV?

A. I am not sure, Number V was not like IV.

Q. Number V had a different design?

A. No, fundamentally the same design, minor differences.

Q. Is No. V an unsuccessful boat?

A. No.

Q. Did you ever have any trouble with Slo-Mo-Shun V? A. Yes. [91]

Q. Was it your hard-luck boat, Mr. Sayres?

A. Well, it was hard luck, but it had certain characteristics that we weren't quite as happy with as we were with No. IV.

Q. Why couldn't you duplicate IV, Slo-Mo-Shun IV?

A. Well, I am not going to sit here and say that you couldn't duplicate it, but I sit here and do say

(Testimony of Stanley S. Sayres.)

that it is awfully seldom that you build two boats and have them come out just the same.

Q. You had the plans for Slo-Mo-Shun IV?

A. Yes.

Q. Do you still have the plans for Slo-Mo-Shun IV?

A. I think they are out at Jensen Motor Boat Company. I don't have them.

Mr. Cromwell: Will you mark this.

The Clerk: Respondent's Exhibit V.

(Respondent's Exhibit V was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit V marked for identification, which is a copy of page 17 of the Post Intelligencer newspaper of Tuesday, December 19, 1950, and under the heading, the article, "Slo-Mo's owner has offers to consider." I refer you to a quote in that article and ask if those are your words.

A. I can't say that they are. [92]

Q. Do you deny then that they are your words?

A. I won't flatly deny it and I won't flatly admit it, because I can't remember exactly what I said to a reporter that far back, the precise wording. General purport of that is correct to a limited extent. Here it says, "Two very fancy offers." I don't think I said, "Two very fancy offers."

Q. Did you have several offers or no offers at that time?

A. No, I think—yes, I think we had had this approach around about presumably from Mrs.

(Testimony of Stanley S. Sayres.)

Dodge. Now, certainly I have had other inquiries about those boats, would I sell it and if I would sell it, how much would I want. I do not believe that I flatly stated I had two very fancy offers.

Q. And you do deny that part of the quote?

A. I would deny that part of the quote.

Q. Now, referring to this part of the quote, did you make that statement, starting here (indicating) with "Unless"?

A. I might have made that, if I had a tentative offer and I wouldn't be sure of anything until it was laid in front of me in tangible form.

Q. That quote states that you wouldn't sell under any circumstances without having a Gold Cup defender, another one already built?

A. I have no doubt that I said that, because in the position of holding the Gold Cup, if I failed to defend it would have moved right back out of Seattle and I would have been [93] certainly unpopular in the area.

Mr. Cromwell: I offer Respondent's Exhibit V.

Mr. Short: The statement he just denied.

Mr. Cromwell: The first ones he denied.

Mr. Short: I object to the competency and relevancy of the exhibit. It is hearsay statement in any event. It can't be even contributed.

Mr. Cromwell: He said he would not sell the first boat unless he had a second boat ready for competition in the Gold Cup.

The Court: Does this purport—who does this purport to be a statement to?

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: By Mr. Sayres.

The Court: To whom?

Mr. Cromwell: To whoever wrote the article.

The Court: Normally the way you prove that is bring in the witness who heard the statement. Now, if Mr. Sayres wants to admit that he said some of this, why, I can accept it.

Mr. Cromwell: He has, your Honor, admitted that last sentence beginning with "Unless".

The Court: It isn't this that is the evidence, it is Mr. Sayres' testimony that is the evidence it seems to me. I think you will have the same result in the record as if you had put this in. I don't think it is competent evidence myself. Unless you have the person here. [94]

Mr. Cromwell: Your Honor, this whole case rests on the business motive versus the hobby motive. Now, if he was in the business of building boats or trying to build these boats up to sell, it seems to me it is very material that this statement is an admission against interest in this case, certainly, and it is a deserving statement. And for that purpose I would like it admitted.

The Court: As I understand it the witness has said that he had had some indirect offers and if there had been a big enough price he would have sold. And he says that he did say at this time that he would not sell, however, unless he had another boat to defend in the races.

The Witness: Yes, sir, that is correct.

The Court: Now, if the petitioner objects to

(Testimony of Stanley S. Sayres.)

that on the grounds of competency, I don't see how I can allow that in evidence.

Mr. Cromwell: Your Honor, if that is so stipulated, that which you have just stated, I will not make any further attempt to put this exhibit in evidence.

Mr. Short: I don't know why you need a stipulation, that is what the man said and the Court has just repeated what he said. I don't know why I am called upon to stipulate to what he has already testified.

The Court: I think that is what the witness has testified and I believe he just said that that was the substance [95] of what you testified?

The Witness: Correct, yes.

Mr. Cromwell: May I make an offer of proof, your Honor?

The Court: You may make an offer of proof.

Mr. Cromwell: If Respondent's Exhibit V was admitted into evidence, it would show the following: In the Seattle Post Intelligencer, Tuesday, December 19, 1950, on page 17 under the heading, the article headed, "Slo-Mo's owner has offers to consider", the following quotation or statement is made by Mr. Sayres, "We have two very fancy offers for the craft. Might sell her if it appears conditions are such that we can build a new one. Unless we can be sure, however, there will be no deal, under no circumstances can we be without a cup defender come August, said Sayres."

The Court: Objection sustained. This is merely

(Testimony of Stanley S. Sayres.)

an article in the newspaper and it doesn't show who wrote it. The person who wrote it is apparently not in court.

(Respondent's Exhibit V was rejected.)

Mr. Cromwell: That is all.

Redirect Examination

Q. (By Mr. Short): Mr. Sayres, was it ever your thought that you were building Slo-Mo-Shun IV for the purpose of selling that [96] particular boat? A. No.

Q. What was your purpose in building the Slo-Mo IV?

A. It was to establish the designs and the ideas that we had gathered together and prove them out.

Q. It was the pilot model of this new design, was it not? A. That is right.

Q. You were asked in reference to—oh, by the way, do you, in the years that you have been interested in the Gold Cup races, has it ever been in your opinion, of any interest to the public who the owner, that is, as between you and the corporation, who the owner of any of these boats was?

A. Not in the least.

Mr. Cromwell: I object, your Honor, Mr. Sayres is not qualified to testify as to what the public feels.

Mr. Short: That is all he was asked about, that is what all of these newspapers are.

Mr. Cromwell: It was what he was held out to

(Testimony of Stanley S. Sayres.)

the public to be, your Honor, not what the public thought him to be.

The Court: He can express his opinion as to what he thinks the public wants. I don't know what weight it would have. I don't think he is qualified to say what the public reaction would be, but he may give his opinion. [97]

Q. (By Mr. Short): Do you have an opinion as to whether it would have made any difference to the public to outline to them the setup of American Properties, Inc., and your relation to the corporation?

A. Certainly in my opinion it didn't mean a thing to the public.

Q. You were interrupted in your explanation of why in the various regattas whether it was Sea Fair or Gold Cup or Harmsworth or any other competition, why these boats or any of them, are raced in your name. Will you explain that?

A. That is the result of the American Power Boat Association, who have jurisdiction over all sanctioned regattas. In the rule book it very specifically states that a corporation cannot enter a boat in a sanctioned race. It goes on and provides that a corporation can charter——

Mr. Cromwell (interrupting): I think the rule book would be the best evidence.

The Witness: It is here.

Mr. Cromwell: You better put it in then.

Mr. Short: Will you mark this.

The Clerk: Exhibit 5 for identification.

(Testimony of Stanley S. Sayres.)

(Petitioner's Exhibit No. 5 was marked for identification.)

Q. (By Mr. Short): Mr. Sayres, when you referred to the A.P.B.A., what [98] do those initials stand for?

A. American Power Boat Association.

Q. I hand you what the clerk has marked for identification as Petitioner's Exhibit 5, and I will ask you what that is.

The Court: I think maybe counsel will agree with you on that.

Mr. Cromwell: No objection, your Honor.

The Court: What is it?

Mr. Short: This is the 1956 Rule Book of the American Power Boat Association, and it bears the caption, "Section 2, Volume 10, No. 4." The clerk has marked it on page 98, where Rule 3 appears, and I will offer the entire volume.

Mr. Cromwell: No objection, your Honor.

The Court: It will be received in evidence.

(Petitioner's Exhibit No. 5 was received in evidence.)

Q. (By Mr. Short): Do I understand that it is your interpretation of that Rule 3 that causes you to enter in competition these boats under your name?

A. Yes.

Mr. Cromwell: I object to his interpretation of it, your Honor, and move that the answer be stricken.

The Court: Strike the answer and rephrase your question. [99]

(Testimony of Stanley S. Sayres.)

Q. (By Mr. Short): Now that this exhibit is now in evidence, will you please now state why you enter the Slo-Mo-Shuns in competition under your own name rather than under American Properties?

A. The rules require it.

Q. Do you know of your own knowledge whether there are unlimited class hydroplanes racing under those rules under the name of individuals, the ownership of which is elsewhere?

Mr. Cromwell: I object to that question, your Honor, as immaterial, as to the ownership of other boats. We are dealing with Mr. Sayres' boats now, Slo-Mo-Shun IV and V.

Mr. Short: We are showing that the practice in the power boat association, as far as racing and the construction of those rules is concerned.

The Court: Your objection is on what grounds?

Mr. Cromwell: My objection is that it is immaterial, your Honor, as to the other boats. We are dealing here with Mr. Sayres' boats, Slo-Mo-Shuns IV and V, and not with somebody else's boats, and his opinion as to what they were or how they were registered or how they would be material.

The Court: And yet you are trying to show that because these rules require that the owner be the man listed that must mean that the boat was owned by him, they are trying to refute that by showing that isn't necessarily so because [100] there are others who have entered boats which they really did not own. Is that the substance of it?

Mr. Short: That is exactly correct, your Honor.

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: Your Honor, the records of the association, the American Power Boat Association, is the best evidence of that. If they want to put the records of the American Power Boat Association in evidence that is all right.

The Court: We are on ticklish ground here because here is the matter of our very case, the question is who owns these boats. It is ticklish to have this witness testify as to who owns other boats. I think we need some very good proof of who was the owner of the other boats. As I say, that is the very controversy here. It could be in the other cases he may want to testify about.

Mr. Short: My point in pursuing this line of testimony is to show that because it is registered in the name of an individual does not deny that the actual ownership is in the corporation.

The Court: You mean it may be leased, chartered?

The Witness: Chartered.

Mr. Short: Well, chartered in an extremely informal way, but that boats owned by corporations are entered in the name of the person, either who drives them or who sponsors them or is interested in them. And it does not affect the question of ownership. It is simply a formal matter of registration for [101] entry in the Regatta. The rules preclude the corporation from making that entry.

The Court: I would have to be pretty sure that I knew that this witness knew the facts regarding ownership.

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: It is not the best evidence, your Honor.

The Court: No, it is the formal matter.

Mr. Short: It is not a matter of formal documentation in items——

Mr. Cromwell (interrupting): I never saw these American Power Boat Association rules before, but Rule 3 of Exhibit 5, Petitioner's Exhibit 5, paragraph 1, states, that "Each boat entered for a sanctioned race must be the bona fide property of the person in whose name she is entered and who must be a racing member of the American Power Boat Association and a member of a club belonging to this Association." Now, the question of ownership of other boats, Mr. Sayres is not qualified to testify to.

Mr. Griffin: The same rule applies that corporations cannot enter.

The Court: If you would like to ask him that question you would have to lay a foundation for showing how he knows.

Mr. Cromwell: Do I understand your Honor's ruling to be—— [102]

The Court (interrupting): I am sustaining your objection at this time unless Mr. Short qualifies the witness further as to his actual knowledge of ownership or how he knows or has some further proof.

Mr. Short: The question was whether he knows.

The Court: You may ask him that question, of course.

(Testimony of Stanley S. Sayres.)

Q. (By Mr. Short): Do you know whether or not in unlimited hydroplane racing any of these boats entered by individuals are owned by other than the individual in whose name it is entered?

A. I can't produce positive proof. I have been told and I think it is correct—I can——

Mr. Cromwell (interrupting): Just a moment, that is hearsay.

Mr. Short: No, that that he said isn't hearsay.

Q. (By Mr. Short): Go ahead.

A. If you will read through the A.P.B.A. book the listing, you won't find any corporation attached to any boat record or any boat performance, it is always an individual, anywhere in it, because it must be entered by the individual, and it can be chartered from the corporation.

The Court: That is under those rules?

Mr. Short: Yes. [103]

Q. (By Mr. Short): And you have Exhibit U before you there? A. Yes.

Q. You see the reverse side of that is an ad for Miss Thriftway, is that an unlimited hydroplane? A. Yes.

Q. Are there a chain of stores known as the Thriftway Chain in this community? A. Yes.

Q. Owned by the Pacific Gamble Robinson Company, a corporation?

A. I don't know the ownership of the chain.

Q. Under whose name is that boat entered?

A. Willard Rhodes.

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: Does he know of his own knowledge?

Q. (By Mr. Short): Do you know of your own knowledge who entered that boat in the Gold Cup races?

A. I am sure the A.P.B.A. records would show that Willard Rhodes owns it.

Mr. Cromwell: Do you know that of your own knowledge?

Q. (By Mr. Short): Does that Sea Fair program, Exhibit U, indicate whose name the Miss Thriftway boat is entered in, the listing?

Mr. Cromwell: The records of the American Power Boat Association are the best evidence. This is certainly not [104] evidence of ownership of other boats and how they are registered.

The Court: I don't think the witness should answer unless he knows.

Mr. Short: I am asking him to look now and see if the exhibit doesn't state that the Thriftway entry is actually under Mr. Rhodes' personal name.

A. Yes, Miss Thriftway, owner Willard A. Rhodes, Exhibit U, page 17.

Q. (By Mr. Short): Who enters Miss Pepsi?

A. Well, I presume it was Walter Dawson. Now, if you have the old program where I can see.

Mr. Cromwell: Do you know of your own knowledge?

The Witness: It was Walter or Roy Dawson, two brothers.

Mr. Cromwell: You are not sure?

(Testimony of Stanley S. Sayres.)

The Witness: I am saying it was one or the other.

Mr. Cromwell: You are not sure?

The Witness: If we can find the program we can tell.

Q. (By Mr. Short): Are there two Dawson brothers? A. That is right.

Q. One of them is always entered as the owner?

A. That is right.

Q. What is the business of the Dawson brothers?

A. It is the Pepsi-Cola Bottling Company of Michigan.

Q. Who enters Such Crust?

A. That was Jack Shafer.

Q. What is Jack Shafer's business?

A. Shafer's Bakers.

Q. Can you furnish us with others?

A. I can say this, here is the entry list and here is the owner named with each boat, and it always is an individual.

The Court: Is this in evidence for that purpose, this exhibit?

Mr. Short: I am not sure what purpose counsel put it in for.

The Court: I allowed the programs in evidence merely for the purpose of showing that this particular boat was entered in the name of this particular individual.

Mr. Short: Yes.

The Court: Now, we have the witness not know-

(Testimony of Stanley S. Sayres.)

ing of his own recollection apparently, who entered other boats, but he is reading from this exhibit.

Mr. Short: Well, to the extent that he is reading from it I would ask that it be admitted for the other entries as well.

The Court: I see. Very well.

Mr. Cromwell: Is that for the purpose of showing ownership, your Honor? [106]

The Court: No, it is not for that purpose.

Mr. Short: That is what you put it in for.

Mr. Cromwell: I put it in to——

Mr. Short (interrupting): I would like an explanation of what he put it in for if it wasn't for ownership.

The Court: He put it in for the purpose of, as I understand it, tending to indicate ownership in this individual. Now, as you say, that doesn't necessarily prove ownership, that mere fact.

Mr. Short: What is the status now? I have offered them for the other entries, the exhibits, to show that they are entered by those individuals despite the fact that they advertise a product.

The Court: Is there any objection to having them in for the purpose of showing what the other entries were and in whose name they were?

Mr. Cromwell: Not as far as the official program is concerned, no, your Honor.

The Court: Very well. They will also be received for that purpose.

Q. (By Mr. Short): Is Greater Seattle, Mr. Sayres, a corporation? A. Yes.

(Testimony of Stanley S. Sayres.)

Q. What is its approximate membership, if you know?

A. I hesitate to answer that. I have seen quotations in [107] the newspapers, but you have a representative from Greater Seattle here.

Q. You say we do?

A. Yes, Mr. VanCamp, the managing director.

Q. Where did you live in 1949?

A. 3140 East Laurelhurst Drive.

Q. Is that in Seattle? A. Yes.

Q. City limits? A. Yes.

Q. Out on Lake Washington? A. Yes.

Q. Have either of the Slo-Mo-Shuns been in the real estate owned by American Properties?

A. Yes, No. IV.

Q. Are any aircraft engines, that is, these Ellison or Merlin engines that you referred to or other parts for the engines and other portions of the boats stored on the properties of American Properties at Broadway and East Madison?

A. Yes. We also do our engine work there.

Q. Do you have a machine shop on the premises of American Properties, which assembles these engines?

A. Well, we have a machine shop of limited scope, yes.

Q. When in your letter to Alexander you indicated that you had paid certain amount of money for the operation, maintenance [108] and construction of these vessels, what does that reference mean? A. Well——

(Testimony of Stanley S. Sayres.)

Q. (Interrupting) In other words, what were you answering when you made that remark?

A. I meant that, well even Greater Seattle or any other organization had not subsidized this program and in saying "I" I perhaps have done that many times, not bothered to write a long explanation of the fact that here was two, here was American Properties, I might say the same thing if you asked me what car I drove down here today, I would say it was my model so-and-so, the car technically belongs to Stanley Sayres, Incorporated, not to me individually.

Q. And Alexander had indicated that Greater Seattle had paid the expense of this Gold Cup to which he had reference——

A. (Interrupting) Which year are you referring to, Ken?

Q. 1953. I remind that your letter is dated September 21, 1953, to Alexander, he had just previous to that, published this editorial, that is the period of time I am referring to.

The Court: Are we going back and testify about that editorial that I refused to allow in evidence?

Mr. Short: Well, I take it that he has answered the question. I may be repeating. I believe that is all. [109]

Recross Examination

Q. (By Mr. Cromwell): Mr. Sayres, when did you move to the Hunt's Point property?

A. Approximately the middle of December, 1950.

(Testimony of Stanley S. Sayres.)

Q. Did you always have a boathouse at the Laurelhurst property?

A. No, just a dock with a cover over it.

Q. Did you keep the Slo-Mos there? The Slo-Mo III, I believe would be the only one you owned in 1949.

A. Yes, it was kept there.

Q. Now, you testified regarding the fact that the engines or some of the engines, anyhow, used in these boats Slo-Mo-Shun IV and V, were kept at the building, American Properties building?

A. That is right.

Q. Who worked on these engines?

A. My own crew.

Q. Your own crew? A. Yes.

Q. Do you mean your crew for your automobile company, American Automobile Company?

A. No, the race boat crew.

Q. Who was there?

A. Well, I named some of them this morning.

Q. Will you repeat those, please?

A. Well, shall I give you the crew as it is today? If I tried to go back, there has been men added and men lost.

Q. Well, maybe I can develop it. Was Mike Welsh on that crew?

A. He has been on all the way through.

Q. And Linen Smith? A. Yes.

Q. Did Ted Jones work on the engines?

A. Well, not on the engines as such, no. He may have assisted. These men know one of them is limited to just one little thing to do.

(Testimony of Stanley S. Sayres.)

Q. In other words, the men that worked on the engines were not employed either by American Properties or American Automobile Company?

A. One man that has worked on engines for the last three years is employed by American Automobile Company, but back in these years he was not on the crew.

Q. Isn't it true that American Automobile Company owned the equipment that was used to work on these engines, Mr. Sayres?

A. Very, very rarely. All the hand tools, the small tools, were not the property of American Automobile Company, and I suppose that at times, why, somebody might be in and use an American Automobile lathe or might use a vise, but we even used an electric hoist up there which did not belong to American [111] Automobile Company.

Q. Who owned the hand tools, Mr. Sayres?

A. American Properties.

Q. Are they on their books?

A. I assume they are.

Q. Well——

A. (Interrupting) I couldn't answer that directly.

Q. When did you build the boathouse on the Hunt's Point property, Mr. Sayres?

A. Well, it was built along at the time that the house was being built, but I can't say when it was finished. I think it was perhaps the spring of '51, although it may have been during the winter. I don't recall the exact dates on that.

Mr. Cromwell: I have no further questions.

Mr. Short: That is all.

The Court: You are excused.

(Witness excused.)

The Court: We will recess for about ten minutes.

(Short recess.)

The Court: On the record, please.

Mr. Short: Call Mr. Griffin.

TRACY GRIFFIN

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified as follows: [112]

The Clerk: Will you state your name and address, please, for the record.

The Witness: Griffin, G-r-i-f-f-i-n, Tracy E. 1616 34th Northwest.

Direct Examination

Q. (By Mr. Short): What is your occupation, sir? A. Attorney at law.

Q. How long have you practiced law?

A. Forty-one years as of July of this year.

Q. In Seattle? A. In Seattle.

I have lived in Seattle for a long time.

Q. Are you a past president of the Seattle and Washington State Bar Association? A. Yes.

Q. Are you presently a delegate from the Seattle Bar Association to the American Bar Association?

A. I am.

Q. How long have you been in that capacity?

(Testimony of Tracy Griffin.)

A. Since 1948.

Q. How long have you represented Mr. Sayres?

A. From the time he came to Seattle, which as I recall, was in the fall of 1931.

Q. I hand you what has been admitted in evidence as [113] Exhibit 4, the record of the Board of Directors of American Properties, Inc. I will ask you if that is your signature?

A. It is, under the heading of Secretary.

Q. Did a meeting represented by those minutes, take place on the day recited in those minutes?

A. Yes, sir.

Q. And is that—

A. (Interrupting) Now, let me qualify that by saying this, the minutes were signed on the day that is shown here, they may have been dictated the day before or something like that. I have no personal recollection of the day.

Q. That is a bona fide meeting that took place when those matters were discussed? A. Yes.

Q. Would you tell the Court what discussion between yourself and Mr. Sayres, Mr. Scott, and/or Mr. Munger, or either or any of them, took place in reference to the ultimate resolution which was passed?

A. Well, my primary discussion was with Mr. Sayres in which he was entering this new venture with Slo-Mo-Shun IV building. And the matter arose of the necessity of incorporating. It is my recollection that Mr. Sayres remembered that the Williams Motor Company, by its very wording,

(Testimony of Tracy Griffin.)

provided for the construction of boats and marine supplies or engines, and that was at that time American Properties, Inc., and that company was [114] in a position to take over this new venture without the necessity and cost of forming a new corporation and setup. That is why it was done. Mr. Sayres very definitely entered into this venture with the idea of not only having it pay its own way, but of being a profitable enterprise. I heard his testimony in regard to the navy situation, I confirm that conversation with him. It was days back there where he was very optimistic and the optimism continued in——

Q. (Interrupting) Optimistic in reference to what?

A. In being able to have a new profitable venture in the building and construction of these boats, the sale of boats, the sale of rights to the boats, perhaps certain marine equipment as time went on.

The Court: May I interrupt?

Mr. Short: Surely.

The Court: Does it appear here that the relationship of two businesses, are there two corporations involved?

Mr. Short: No, there are two names to the same corporation, Williams Motors was the original corporation that Mr. Sayres acquired, changed its name to American Properties.

The Court: Isn't that another company?

The Witness: I might testify about that.

(Testimony of Tracy Griffin.)

Mr. Short: There is an American Automobile Company.

The Court: Yes, well what relation is that to the other corporation, any? [115]

Mr. Short: It is the tenant of American Properties. The American Automobile Company, which is now Stan Sayres, Inc., this is confusing because of the name change, but American Automobile Company was the Chrysler-Plymouth first distributor and then dealer. That corporation's name has been changed now to Stan Sayres, Inc. That is the one that operated until a month ago. The Chrysler-Plymouth dealership and the premises which it occupies, are owned by American Properties.

The Court: Are both of them corporations?

Mr. Short: There is only one item of property. It is occupied by the automobile dealership.

The Court: I understand, but first you have the corporation that owns the building?

Mr. Short: That is right.

The Court: What is the name of that?

Mr. Short: American Properties.

The Court: And the taxpayer, Mr. Sayres, owns practically all the stock of that?

Mr. Short: That is true.

The Court: What about the dealership, is that—that is not a corporation?

Mr. Short: Yes, that is Stan Sayres, Inc., formerly American Automobile Company.

The Court: And Mr. Sayres owns that, too?

(Testimony of Tracy Griffin.)

Mr. Short: He does not own all but the qualifying [116] shares as he does in the other, there are other stockholders in that corporation, but he is the principal stockholder.

The Court: Is that material here? It is somewhat confusing.

Mr. Short: I think this witness can straighten it out.

Q. (By Mr. Short): Did you organize American Automobile Company?

A. Yes, sir, the American Automobile Company was organized at the time or about the time, that Mr. Sayres commenced business in Seattle and at about the time that the change of name of the Williams Auto was made Mr. Sayres had at that time two substantial stockholders and about 1946 or '47, acquired all of the stock of American Automobile Company, that is the distributor and retailer of these cars, except one qualifying share, of which I held. And he continued to operate that company, that is American Automobile Company, there were some changes, which are not material herein, I think at one time becoming a partnership and then back to a corporation again, but finally a corporation which continued to operate as such, distributor until a few weeks ago when a sale was made of assets, in the meantime its name had been changed to Stan Sayres, Inc., but I organized both the original company, all subsequent companies, and partnerships, and the change of name and change of stock of Williams Automobile Company, and those [117]

(Testimony of Tracy Griffin.)

date back to 1932. The American Automobile Company rented the premises from the American Properties after American Properties acquired that property at Broadway and Madison.

Mr. Short: Does your Honor have further questions on that?

The Court: No.

Q. (By Mr. Short): What is your recollection as to whether or not the possibility of the government as purchaser of these high-powered boats was contemplated and discussed?

A. As I said, I heard Mr. Sayres' testimony about the Navy, they were very optimistic back in those days because that wasn't too long after they had had the experience with the PT boats in the Phillipines. I should explain one other matter perhaps in regard to these corporations. An additional reason that the, this venture did not go into American Automobile Company was primarily at that time American Automobile Company was not locally owned, there were other stockholders aside from the qualifying shares, and regular reports had to be made to the Chrysler Corporation on their forms and so forth, and if there was another side venture it would just complicate a situation that didn't require it.

Q. In reference again to this Navy question, I call your attention to the next-to-the-last sentence on page 1 of that resolution which states that, "He", referring to Sayres, [118] "believed that the government would itself be interested in the fastest

(Testimony of Tracy Griffin.)

type of boat that could be manufactured." To what does that refer?

A. Well that refers to the type of boat that Ted Jones had designed, they intended to try out, figuring that Slo-Mo IV was going to be it.

Mr. Short: Your witness.

Cross Examination

Q. (By Mr. Cromwell): Mr. Griffin, do you have a pecuniary interest in this action?

A. None except I expect to charge for per diem for services rendered when we are through.

Mr. Cromwell: That is all.

The Court: You may be excused.

(Witness excused.)

Mr. Short: Simply to correct the record, I think I made a reference to Williams Motor Company. It is actually William Auto Company, to the extent that that is an error, I wish the record to show it.

Call Mr. Munger.

ALBERT R. MUNGER

was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows: [119]

The Clerk: Will you state your name and address for the record, please.

The Witness: Albert R. Munger, M-u-n-g-e-r, 4520 West Laurel Drive, Seattle.

Direct Examination

Q. (By Mr. Short): What is your occupation, Mr. Munger?

A. I am retired.

(Testimony of Albert R. Munger.)

Q. Before you retired what was your occupation?

A. I retired from the presidency of the Seattle First National Bank.

Q. When did you retire from that position?

A. On the 31st of December, 1953.

Q. In reference to other banking institutions in the State of Washington, what is the relative size of the Seattle First National Bank?

A. Well, it is by a considerable degree the largest banking institution in the state.

Q. How many branches do you operate or did you operate, when you were with them?

A. I think we had 56 at the time that I retired.

Q. In 1949 was it the largest banking institution west of Chicago and north of San Francisco?

A. I think that is true.

Q. In 1949 what was your capacity with the bank? [120]

A. In 1949 I was Chairman of the Loan Committee.

Q. And were you located at the main office?

A. I was.

Q. That is in the Dexter Horton Building in Seattle? A. It is.

Q. Are you acquainted with Mr. Sayres?

A. Well, from the time that he first engaged in Seattle which was in 1931 or '32.

Q. Is it fair to state that you are and have been his financial adviser over those years?

(Testimony of Albert R. Munger.)

A. It is, in addition to the fact that I was his banker. Yes.

Q. What I am getting at, did he consult you from time to time on the—seek your advice as to business ventures?

A. I think it is probably very true that he has not entered into any considerable business venture or decision in all these years since '32, that he hasn't consulted me if I was in the city.

Q. Did you have occasion to consult with him in reference to these unlimited class hydroplanes?

A. I did.

Q. State if you will, then, that is, when there was any discussion with you and Mr. Sayres as to any business venture connected with those boats.

Q. Without being able to specify any positive individual [121] date, I would say that it was in 1939 that our conversations first started on that subject.

Q. At that time what kind—what boat—

A. (Interrupting) Did I say '39? I mean '49.

Q. Yes. In 1949? A. Yes.

Q. Then you can strike that question I was starting to ask. Who participated in those discussions besides yourself?

A. I think at times Mr. Griffin. At other times perhaps Mr. Scott, but most frequently I think that Mr. Sayres and I were alone in our conversations.

Q. What was the general purport of Mr. Sayres'

(Testimony of Albert R. Munger.)

questions, what was his plan that he was seeking your advice about?

A. Well, so far as the business aspect of going into the manufacture and sale of boats was concerned, his question of me was my opinion on the desirability of entering into that venture as a business enterprise.

Q. And specifically doing what in a business way with the boats?

A. To make an arrangement with Ted Jones and Anchor Jensen whereby the three together would be interested in the building and the sale of boats of the type that Mr. Jones had designed.

Q. What ultimately evolved in that discussion?

A. Well, my advice to Mr. Sayres was favorable to the [122] venture, I advised him that in my opinion it was sound and promising business venture.

Q. And did you make any recommendation to him as to any corporate organization?

A. I cannot distinctly remember making any recommendation on my part, but I was a party to the discussions that involved in what ownership and in what form that business should be conducted. I had only one stipulation in respect to the base interest that he should not enter into it individually.

Q. I see. I take it from that he should either organize or select a corporation?

A. That was the effect of it.

Q. Did you ever hear the subject of the Navy mentioned or discussed in any of those conversations?

A. Oh, yes.

(Testimony of Albert R. Munger.)

Q. In what regard?

A. Well, it was one of the factors that was of importance in making up one's mind as to the desirability of the business venture, and the circumstances were that we all had in mind the experience with the P-T boats during the war with the thought that they had been extremely valuable to the Navy and that it might very well be that the Navy would become a very important customer for this business venture in the development and the purchase of the successor models of the P-T boats for use in rescue and in all other affairs where speed was the prime [123] requisite because in my opinion it was evident that a boat designed along these lines would be far speedier and more useful to the Navy than the P-T boats had been in the recently ended war.

Q. Other than the Navy and/or Coast Guard or other government user of high speed boats, what other prospective purchaser or purchasers was it anticipated would buy this type of high speed vessel?

A. Well, in my thinking there were probably a large number of prospective purchasers for these reasons, first, it was evident in our minds at least, that Ted had designs here that would just revolutionize the capacity and the construction of these unlimited hydroplanes, in the second place, he was able to build them for what seemed to me a rather modest cost, in the third place, that those people interested in owning and operating racing boats

(Testimony of Albert R. Munger.)

of this type had been accustomed to spending much larger sums for their boats, and that they would readily pay prices for these new developments that might run to two or three times the actual cost of producing the boats. In other words, it could be very profitable.

Q. Did you, when I say you, I mean your bank, the Seattle First National Bank, have any occasion to invest by loan or otherwise in this venture?

A. Mr. Sayres borrowed for the American Properties, Inc., [124] a sum of money that I think was between twenty-five and thirty thousand dollars, sometime after our conversations, and I think probably in the year 1950.

Q. Did you approve that loan or at that time were you on the loan committee, do you recall?

A. I was chairman of the loan committee, but I was not an active loan officer, that loan was made by a loan officer in one of our branches. It came before me for approval in the normal run of the bank's business.

Q. The borrower on that loan was who?

A. American Properties, Incorporated.

Mr. Short: Will you mark this.

The Clerk: Exhibit 6 for identification.

(Petitioner's Exhibit No. 6 was marked for identification.)

Q. (By Mr. Short): Handing you what has been marked for identification as Petitioner's Exhibit 6, will you identify what that document is?

A. This represents a notice of credit to the

(Testimony of Albert R. Munger.)

American Properties, Inc., dated August 7, 1950, representing a——

Q. (Interrupting) In what amount?

A. Of \$26,000, in the form of a note.

Q. That appears to be the Metropolitan Branch. Is that where the account of American Properties was carried? [125] A. That is true.

Q. Where is that branch?

A. In the White Henry Stewart Building on 4th Avenue.

Mr. Short: I will offer Petitioner's Exhibit 6.

Mr. Cromwell: We ask for production of the note referred to there, that is the best evidence of that loan.

The Court: This seems to represent a deposit with the bank in the amount of \$26,000.

Q. (By Mr. Short): Is that in fact, a deposit by American Properties or is that a bank credit to the account of American Properties?

A. That is the customary notice of credit for the proceeds of a note of borrowing.

Q. Can you now tell——

Mr. Cromwell (interrupting): I object to this, your Honor, the note is the best evidence of this, the witness has testified that he didn't of his own knowledge, make this, himself make this.

The Court: If the witness has a recollection that there was a loan made and states that this is the notation of it on the records of the bank, I think it is admissible. Does the witness know?

Q. (By Mr. Short): Do you have a recollec-

(Testimony of Albert R. Munger.)

tion that there was a loan made to American Properties and that that is Exhibit 6, the notation [126] of the deposit to the account of the borrower?

A. I think I can clearly state that that is the case.

Mr. Cromwell: You think, do you know that to be a fact? A. I didn't make the entry.

Q. (By Mr. Cromwell): Who made the entry?

A. The entry was made in the Metropolitan office of the Seattle First National Bank.

Q. Do you know that to be a fact?

A. Only by reason of this notice, and the fact that the note, that the borrowing was made in that office.

Q. But you don't know who made this——

A. (Interrupting) What particular officer or what particular clerk?

Q. Or that it was actually made other than in statement here?

A. I know by my memory that there was such a loan, that it came before me in the normal course of review of loans in my capacity as the head of the loan department.

Q. Do you know of your own knowledge that this loan was made on 8/7/50?

A. I couldn't say from my own memory that it was on that date, it was on or about that time, in that year.

Mr. Cromwell: I object to this, your Honor, it is [127] not properly identified.

The Court: I will receive it in evidence.

(Testimony of Albert R. Munger.)

(Petitioner's Exhibit No. 6 was received in evidence.)

Q. (By Mr. Short): Do you have a recollection now——

Mr. Cromwell (interrupting): Just a minute. I would like to note my exception to your ruling regarding the admission of that exhibit, which is Petitioner's Exhibit 6.

The Court: Your objection is noted.

Q. (By Mr. Short): Can you state of your own knowledge that that loan was made to the company in reference to—for use in connection with the production and maintenance of these boats as distinguished from the other function of the corporation? A. I can.

Mr. Short: I think that is all.

Cross Examination

Q. (By Mr. Cromwell): Mr. Munger, what collateral was given for this note?

A. No collateral.

Q. No collateral was given for it? A. No.

Q. Did you ever personally see the note?

A. No, it would be very improbable that I saw the note. [128]

Q. Your answer to that question is no, you did not see the note?

A. That is correct.

Q. Did you personally handle the transaction which resulted in the loan? A. No.

Mr. Cromwell: That is all, your Honor.

(Testimony of Albert R. Munger.)

Mr. Short: That is all.

The Court: I would like to ask this question of the witness.

Did you say you knew what this was to be used for?

The Witness: I knew that it was to be used for the operations in connection with the boats, because the corporation, as far as I ever knew, had no occasion to borrow otherwise.

The Court: Did you know that?

The Witness: Well, I was very familiar with its affairs on a day-to-day basis almost.

The Court: I don't suppose you know how it actually was used?

The Witness: No.

The Court: Very well, you are excused.

(Witness excused.)

Mr. Short: Call Mr. Scott. [129]

HAROLD L. SCOTT

was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows:

Mr. Cromwell: Your Honor, I would like the record to note at this time that Mr. Harold Scott who is on the witness stand is entered as counsel of record for petitioner, American Automobile—American Properties, Incorporated, and also entered as a counsel for petitioners Stanley Sayres and Madeleine Sayres in this controversy.

(Testimony of Harold L. Scott.)

The Clerk: Will the witness please state his name and address for the record.

The Witness: Harold L. Scott.

Direct Examination

Q. (By Mr. Short): Where do you reside, Mr. Scott?

A. 8111 Blue Ridge Drive, Seattle.

Q. And your occupation?

A. Certified Public Accountant.

Q. With whom?

A. I am a partner in Pete Marwick & Mitchell.

Q. And how long have you handled the accounting affairs of the taxpayers in these three docketed cases?

A. I think I have handled Mr. Sayres' companies and his personal, since 1932, when he first started in Seattle. It might have been the latter part of '32 or early '33, I can't [130] remember exactly.

Q. Mr. Scott, do you maintain the ledgers, journals for Mr. Sayres and the various corporations in which he is interested?

A. No, sir, we do not, except in this case of American Properties, we had one of our men go up and go through all of the invoices and check and set up the opening entries in the books in 1949.

Q. All right. Were you aware before this hearing today that the respondent was challenging in this proceeding, the items of expense attributable to these boats?

(Testimony of Harold L. Scott.)

A. I did not know that he was challenging the validity of the expenditures by the corporation except to say that they were not allowable deductions of ordinary and necessary expenses of the corporation.

Q. Was that by reason of their claim that it was the hobby of Mr. Sayres?

A. Yes, sir.

Q. Are you now prepared to establish those expense items? A. Yes, I believe we are.

Q. Perhaps if you could just—you are aware of Exhibit A in evidence? You have seen that document before it was offered? A. Yes, sir.

Q. I show you what is in evidence as Exhibit A not perhaps in that form, but have you seen that breakdown of figures? [131] A. Yes.

Q. And that was prepared by whom?

A. Prepared by one of the government men.

Q. And was previously furnished to you?

A. I believe it was taken directly from our work papers.

Q. Do you need the returns to substantiate the items of expense or can you do it from what you have?

A. I think I can do it from the work papers. For the year 1949——

Mr. Cromwell (interrupting): Just a minute, your Honor, I object to the witness testifying from the books, they are not in evidence. I also object to them being put in evidence on the grounds that Mr. Scott didn't keep these records.

(Testimony of Harold L. Scott.)

Q. (By Mr. Short): What is it that you have before you?

A. I have the work papers that we have made up in our office in connection with the preparation of the '49 and the 1950 income tax returns of American *Products*.

Q. Are those work papers and the preparation of those returns under your personal supervision?

A. Yes, sir.

Q. You, in fact, signed those?

A. Yes, I did.

Mr. Short: I feel he is competent to testify.

The Court: I think not. [132]

Mr. Cromwell: The books and the records are the best evidence.

The Court: The books and records are the best evidence. However, if he had a summary here of extracts from the books and the books are in the courtroom, I think it would be admissible.

Q. (By Mr. Short): Do you have such summary?

A. The books are in the courtroom and the books have been prepared from these work sheets to the end of December 31, 1949.

The Court: The books have been prepared from this?

The Witness: Yes. These are the original work sheets that we examined invoices and/or other supporting papers for all items below.

The Court: These do constitute the original records?

(Testimony of Harold L. Scott.)

The Witness: These are the original, yes, sir.

The Court: And they were under your supervision?

The Witness: Under my supervision.

Q. (By Mr. Short): Mr. Scott, let me ask you this, too, prior to your becoming a partner in Marwick-Mitchell and Company, you operated as a sole trader doing business as Harold L. Scott and Company?

A. It was a partnership under Harold L. Scott and Company for many years.

Q. And you handled the affairs of Mr. Sayres and his [133] corporations prior to your becoming a member of Pete Marwick & Company?

A. Yes.

Q. As long as he has been in business in Seattle? A. That is correct.

Q. Do you have a personal acquaintanceship with his affairs and the affairs of his corporations?

A. Have had for many years.

Mr. Short: I submit he is qualified.

Mr. Cromwell: Your Honor, these are not the original records of the corporation.

Did you prepare these, Mr. Scott, yourself?

The Witness: No, they were prepared by James Fisher.

Mr. Cromwell: Then I object to their admission, your Honor, they haven't been properly identified, they are not original records.

The Witness: They were prepared under my supervision taken from invoices and/or other sup-

(Testimony of Harold L. Scott.)

porting papers. There were no books of the company.

Mr. Cromwell: Doesn't the corporation keep journals and ledgers?

The Witness: It didn't have at that time. They were kept in memorandum form. Mr. Miller, in examining it, I am sure, built up most of his information right from this record here. He knows what it is. Mr. Miller is the revenue agent, the [134] examiner.

Mr. Cromwell: Is Mr. Fisher available?

The Witness: He is not with our firm at this time. I think we could locate him. It might take a day, it might take two days. If we have got to go over until Monday I believe we might be able to locate him.

Mr. Cromwell: We insist on having Mr. Fisher identify these records, your Honor.

The Court: Who is Mr. Fisher?

The Witness: He is one of our staff members.

Mr. Short: In view of the fact that Mr. Scott closely enough supervised the work of Mr. Fisher to be prepared to sign the return and due to his personal acquaintanceship with Mr. Sayres' affairs, he is as qualified, if not more so, than Mr. Fisher.

The Court: You have the record now?

Mr. Short: I assume so, this is a surprise phase of the case to me.

The Court: The records that are in the court here, the permanent records of the corporation, would they show the same thing?

(Testimony of Harold L. Scott.)

The Witness: Mr. Miller has made this exhibit A from our paper.

Mr. Cromwell: That is not a correct statement. This was made by the technical adviser who did not make the examination [135] of the books and records.

Mr. Griffin: The documents supplied by the government we accepted the figures and assumed the government would accept them, on the one hand they say these items are not expense and then on the other hand they charge you the same identical items on the other side of the ledger. Now, it is technical, we can introduce all of these books if we have to, and everything there is, but why should it be done when it is the government's own figures that we are willing to accept?

Mr. Cromwell: It is just elementary that when we disallow expenses to a business as not being ordinary and necessary they have got to prove them. It is just elementary.

The Court: Of course I understand that disallowance carries with it, unless there is some qualification, a disallowance of the figures themselves, too. However, it seems to me that the parties should be able to get together and show what the books show in regard to these expenses, whether the government wants to concede that or not, we could at least show by stipulation what the books show on it.

Mr. Short: All the books are present, are they not?

(Testimony of Harold L. Scott.)

The Witness: Yes.

The Court: How much of a job would that be?

The Witness: I am sure that Mr. Miller the revenue agent, has all of the figures that were taken from the books. [136]

Q. (By Mr. Short): How long do you think in terms of time to cover the matter of these expense itmes? What do we have, two fiscal years involved?

A. We have two calendar years involved with the corporation, and it involves Mr. Sayres' on a fiscal year, October 31st, and therefore, we have got to go through the two fiscal years.

The Court: I prefer not to have testimony of a witness as to what books show. I would prefer to have some instrument purporting to be an extract from the books.

Mr. Short: What time do you ordinarily adjourn? I am just calculating as to whether the weekend is available for that kind of a summary.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Short: That concludes our proof except for the matter of the summary.

Mr. Griffin: On this phase?

Mr. Short: I think it is understood that we go into the salary question when we finish this.

Mr. Cromwell: Let them go ahead and call their witness on that, your Honor, and finish their case.

Mr. Short: We had already stipulated that we

would try this when we had concluded this case. The salary question [137] will take very few minutes. I prefer to conclude on this matter now rather than to start the salary question now, which is unrelated.

The Court: I am not sure I understand what the agreement was. Does the government care to go ahead with its side of the case? Normally the taxpayer goes ahead with its whole case.

Mr. Cromwell: I would prefer if the taxpayer should proceed.

The Court: Is there any reason that you shouldn't go ahead with your whole case?

Mr. Short: Not except that we stipulated we wouldn't but if he wants to change it I am willing.

The Court: Well, all right.

Mr. Cromwell: Your Honor, I might state if it will accommodate the petitioner, that I will proceed with the respondent's case with regard to the boat issue provided it will be stipulated that when I finish and they have finished with their cross-examination of my witnesses, that that will close that issue as far as the record is concerned, with the one exception of the stipulation of Mr. Brougham's or the deposition of Mr. Brougham, which we mentioned this morning.

Mr. Short: Do I understand you are asking me to waive rebuttal on your case?

Mr. Cromwell: No, I will conclude very quickly my [138] case regarding the boats, and you may proceed with your cross-examination regarding that and then we will close that phase of the case.

Mr. Griffin: We may have rebuttal, of course.

Mr. Cromwell: Provided it is terminated today. I can finish in perhaps the next half hour with my case.

Mr. Short: I don't want to be simple-minded, but what are you suggesting that I didn't suggest. How do we differ?

Mr. Cromwell: I want to be sure that counsel for petitioner will agree that should we proceed with the boat issue to a conclusion, that we won't come in Monday morning with rebuttal witnesses. I want the record closed as far as the boat issue is concerned if we are going to proceed in this manner.

Mr. Griffin: I may say to you now, sir, that with a statement of that kind that you are asking us to accept your witnesses without rebuttal, we will not so do. We don't know what you are going to present.

Mr. Cromwell: O.K. Put your case on then.

Mr. Short: That is what I thought you meant. I call the Court's attention that this battery of people are here on the boat issue, these last items on the Docket 57751 and 57749 and 50, relate to Mr. Sayres' salary from two corporations, the Jen-Cel-Lite Corporation and the American Automobile Company, Incorporated, now Stanley Sayres, Incorporated.

On the first of those docket numbers in reference to [139] the salary item itself, the taxpayer concedes that the salary item which is in the amount

of \$3,200 is properly assessed, but that the negligence penalty is improperly assessed.

In reference, however, to Docket 57749 and 50, the taxpayer challenges both the assessment of salary and penalty. I will cover briefly in this brief opening statement, the Jen-Cel-Lite matter. Both of these things arise on error by bookkeeping or accounting personnel in confusing the fiscal years of the individual taxpayer and the corporation paying the salary.

The Jen-Cel-Lite Corporation—well, Stan Sayres himself at all times material to this controversy and now, was on a fiscal year of October 31st as I think the record already demonstrates. In November, 1949, Jen-Cel-Lite Corporation declared and fixed Mr. Sayres salary at \$4,000 for the period July 1 to November 30, 1949. They, by that corporation by the way, is on a calendar year of November 30th. Commencing December 1, 1949, his salary was to be \$800 a month. It is readily apparent that the \$4,000 salary from July to November is likewise \$800 a month. By reason of Sayres' personal return being on a calendar—fiscal year ending October 31, it is also at once apparent that at the time that salary was declared to him his taxable year had already closed. And in fact, may well have filed his return for all I know.

The Court: Was he on a cash basis, too? [140]

Mr. Short: Yes, he individually is on a cash basis, therefore there was credited to his account in the Jen-Cel-Lite Corporation the \$4,000 salary covering a five-month period, four months of which

were in his previous fiscal year and that constitutes the \$3,200 item, and the remainder, of course, went into his next successive year which caused, when he filed his return he filed it on the basis of \$800 a month as of October 31, 1950, and failed or accountants failed to pick up the retroactive \$3,200 that happened to have fallen into his previous fiscal year, but by reason of the time of the declaration, had already been filed.

In the American Auto salary, that is not quite that simple. The American Automobile Company was on a fiscal year of April 30. Up until—at all times prior to April 30, 1948, that is, at all times material at least, Mr. Sayres' salary as president of American Automobile Company, was \$30,000 a year. On April 23, 1948 the record will show that his salary was increased to an annual salary of \$42,000 a year and that would be effective for the year ending—well, strike that. Again in that year Mr. Sayres' personal return was on an October 31st fiscal year. That resulted—when the accountant called Mr. Harry Potter, who is the treasurer of American Auto, to inquire as to the present status of Mr. Sayres' salary, he was advised correctly that his salary was \$42,000 a year. The accountant, who is Mr. Peterson, now deceased, automatically divided that [141] by 12 and posted to his account that figure which by reason of the difference in fiscal years, caused an additional thousand dollars a month to accrue to Sayres for November, December, January, February, March and April, that is, for the period between the end of his fiscal year, October

31st, and the beginning of the declaration of the \$42,000 salary, effected May 30, 1948, so that \$8,000 difference is the matter in issue.

There are two docket numbers because separate returns were filed, and there is \$3,000 on each return. The evidence will show that Mr. Sayres does not in either corporation or in any corporation, draw a monthly salary check. These are by postings to his account and drawings from the account in amounts which bear no relation to his monthly salary when the return was filed he personally did not know of the situation that is related here, your Honor, and the evidence will show that it was his intent, and the intent of the corporation, to declare him a salary of \$42,000 per year, but not more than \$42,000 in any one year, but the actual confusion is Peterson's assumption as the Court can appreciate almost without the testimony, the false notion that the fiscal year of both the corporation and the taxpayer were the same.

The evidence will also show that during that period of time when—you see, these two salaries and these two corporations are both charged to the same taxable period, but there was never any period of time in that area when the W-2 would ever agree with the actual amount received by the [142] taxpayer because of the fiscal year not coinciding not only between Sayres and American Auto, but between American Auto and Jen-Cel-Lite. So the W-2 would be no indication that there was anything amiss. And it is our contention that as far as the American Auto salary is concerned, the amount

was not actually received by the taxpayer, that the negligence penalty does not lie in the Jen-Cel-Lite case. However, 57751, we concede that despite the fact the taxpayer didn't know it, that amount was received and is, therefore, as far as the salary was concerned, is conceded, but the negligence penalty is challenged.

The Court: The negligence penalty was what?

Mr. Short: A five per cent penalty was assessed, not that item as segregated, but against the total adjusted item which I think includes the boat issue as well, the entire 1949 and '50 readjustment.

Mr. Cromwell: It includes only the salary issue.

The Court: What is that negligence penalty, failure to file an estimate or a timely return or what?

Mr. Cromwell: That is a failure to properly report your income, your Honor.

The Court: I am very glad to have that explanation. It wasn't entirely clear to me. It is rather complex, but I suppose it will clear up.

Mr. Short: The accountant can explain the manner in which the error occurred in both instances. I am not sure the [143] taxpayer can, but I will call him for the purpose of stating——

The Court (interrupting): Let us move right along, then.

Mr. Short: Call Mr. Sayres.

STANLEY S. SAYRES

having been previously sworn, was recalled and testified further as follows:

Redirect Examination

Q. (By Mr. Short): Mr. Sayres, you have previously been sworn. A. Yes.

Mr. Short: Will you mark this.

The Clerk: Petitioner's Exhibit 7 for identification.

(Petitioner's Exhibit No. 7 was marked for identification.)

Mr. Short: Will you mark this.

The Clerk: Petitioner's Exhibit 8 for identification.

(Petitioner's Exhibit No. 8 was marked for identification.)

Mr. Cromwell: Your Honor, this negligence penalty is assessed on the whole deficiency, but it specifically relates to failure to report the full amount of salary.

Mr. Short: As I understand the negligence is claimed on these items I just referred to, but it is computed on the basis of the entire returns. [144]

The Court: What is that provision of the law?

Mr. Cromwell: 293-A.

The Court: It is on the whole deficiency?

Mr. Short: Yes.

Q. (By Mr. Short): Mr. Sayres, I hand you what has been marked for identification as Petitioner's Exhibit 8 and I will ask you if that is your signature as president on those minutes?

(Testimony of Stanley S. Sayres.)

A. Yes.

Q. And that is the signature of Ralph Hanson?

A. Well, Ralph was secretary at that time.

Q. And that is his signature, is it?

A. Yes.

Q. And that is the original minutes of the meeting of the Board of Directors of American, for April 23, 1948, is it not? A. Yes.

Mr. Short: I will offer Petitioner's Exhibit 8.

Mr. Cromwell: Respondent has no objection.

The Court: It will be received in evidence.

(Petitioner's Exhibit No. 8 was received in evidence.)

Q. (By Mr. Short): Mr. Sayres, those minutes reflect that on that date, April 23, 1948, your salary was increased to \$42,000 a year? A. Yes.

Q. What was your salary prior to that time?

A. Thirty, as I recall it.

Q. You attended that meeting, I take it?

A. Yes.

Q. And would you state what the intention of you and the other directors in—as to that \$42,000 salary, as to when it was to commence?

A. Well, there was certainly no intention to make it retroactive, never a thought in the world of that.

Q. What was it that it was contemplated that you would be paid in any one year?

A. \$42,000.

Q. Do you draw, Mr. Sayres, a salary check or have you ever drawn a uniform monthly salary

(Testimony of Stanley S. Sayres.)

check, from American Automobile? A. No.

Q. How about the Jen-Cel-Lite Corporation?

A. I have drawn a regular salary check from Jen-Cel-Lite since I felt it could pay me a salary.

Q. That hasn't always been true?

A. That is right.

Q. When did you first discover that there had been appropriated to the period November, December, January, February, March and April, ending April, 1948, an additional \$1,000 a month to your salary? [146]

A. Not until Mr. Scott told me and that was long after. I can't recall just how long.

Q. Were you at any time aware that you were being credited with a salary of anything in excess of the amount stated in that resolution?

A. No, certainly I would have corrected it if I had have been.

Q. Now, in reference to, well again in the—this covers the same year in the Jen-Cel-Lite Corporation when your salary in the sum of \$800 a month was declared, when were you first aware that the \$800 for the last four months of your fiscal year ending October 31, 1948 was unreported on either your return for the fiscal year ending October 31, 1949, or October 31, 1950?

A. Well, also at the time Mr. Scott told me about it.

Q. Were you in the practice of furnishing at

(Testimony of Stanley S. Sayres.)

that time Harold Scott and Company, with the information necessary to compute your return?

A. Yes.

Q. What information did you furnish to Harold Scott and Company covering these periods?

A. Well, I imagine that it was about the standard practice, what interest I might have paid, what donations, any, well, income from dividends or anything of that nature.

Q. Do you have a recollection as to how the matter of [147] what your salary for that period was, how that was established by Harold Scott and Company and by whom in Harold Scott and Company?

A. Well, I understand this whole set of errors was made by Mr. Peterson.

Q. Did he call your office in reference to what your salary was?

A. He called and talked to Mr. Potter, so I am informed.

Mr. Short: Can I interrupt the witness a minute. Mr. Griffin, is that your signature on Exhibit 7 as secretary of the American Automobile Company?

Mr. Griffin: Yes, sir.

Mr. Short: I will offer Exhibit 7.

Mr. Cromwell: No objection.

Mr. Short: That, if the Court please, identifies the minutes for the succeeding year, and identifies the salary for the succeeding year.

(Testimony of Stanley S. Sayres.)

(Petitioner's Exhibit No. 7 was received in evidence.)

Q. (By Mr. Short): I hand you, Mr. Sayres, what will be marked for identification as Petitioner's Exhibit 9, and I will ask you if that is your signature on that document? A. Yes.

Q. And as President of American Automobile Company? [148] A. Yes.

Q. And the signature of Ralph Henson as secretary? A. Yes, that is right.

Mr. Short: May I correct the record. What I referred to as Exhibit 7 when I handed it to the Court is actually the meeting of the Board of Directors of Jen-Cel-Lite, and what will be marked as Exhibit 9 is the \$42,000 salary resolution for the year 1949.

The Court: Exhibit 7 will be received in evidence.

Mr. Cromwell: I have no objection to Exhibit 9.

The Court: Exhibit 9 also will be received in evidence.

(Petitioner's Exhibit No. 9 was marked for identification and received in evidence.)

Mr. Short: I think that is all.

Mr. Cromwell: Respondent has no questions.

The Court: You are excused.

(Witness excused.)

Mr. Short: Call Mr. Scott.

HAROLD L. SCOTT

having been previously sworn, was recalled and testified further as follows:

Direct Examination—(Continued)

Q. (By Mr. Short): Mr. Scott, your Harold Scott Company was handling the [149] returns of American Automobile Company, Incorporated, Jen-Cel-Lite and Mrs. Sayres, for the year 1949 and 1950, were you not? A. Yes, sir.

Q. Are you acquainted with the error to which I made reference in my opening statement?

A. Yes, I am.

Q. Correcting—calling your attention to the one in reference to the American Automobile Company, the salary of \$42,000 which was declared in April, 1948, would you explain in what manner those entries were made and how the returns were made up?

A. When Mr. Sayres came in to make his return for the year ended 19—October 31, 1948, he gave Mr. Peterson, who had been with me for about 25 years, he had been a very reliable man, and——

Q. (Interrupting) Let me interrupt you. Is he dead? A. Yes.

Q. When did he die?

A. He died January 23, 1953.

Q. Proceed.

A. And he received this information from Mr. Sayres as had been customary for many years, and handled the supervision of audits and tax returns for these companies. For some reason he did not

(Testimony of Harold L. Scott.)

go back to the files of the corporation to see how—see what amounts had been credited to Mr. Sayres, and overlooked [150] a credit on the books of American Automobile Company at April, 1948, of \$12,000, which was in effect giving an increase starting with November 1, 1947, through March, of \$1,000 a month. And since the company was on one fiscal basis and the individual on another, it just got overlooked as far as we can see. We cannot figure out, and whether Mr. Peterson was negligent about it. He made the mistake, there is no question about it, and I knew nothing of it until Mr. Miller, the revenue agent, called it to my attention. We have handled several hundred returns a year and with the split years and withholdings that do not agree it is a difficult thing to always catch every item.

Q. Do you know of any manner in which——

A. (Interrupting) One point I would like to make also. It was just absolutely no intent of anything, no negligence of anyone in this matter in any way, as far as I can see. We tried our best to keep our returns correct.

Q. Is there any way that you can conceive of that this matter would come to the attention of Mr. Sayres?

A. No, I do not, because he did not go to his ledgers and look to see what entries were put on. This entry of \$12,000, Mr. Peterson sent up to the company to put on the books and credit Sayres' account with the \$12,000.

(Testimony of Harold L. Scott.)

Q. That book entry does not represent actual disbursements in money to Sayres?

A. It is just journal voucher. [151]

Q. Would the W-2 issued by the corporation to the person receiving the salary either reflect or put Mr. Sayres on notice of the error that was made?

A. I don't believe so, unless a person was very familiar and checked out the withholding with the amount of salary they would not notice it. Peterson didn't notice it and the withholding was made.

Q. Well, the withholding corporations and the individuals, three of them——

A. (Interrupting) That is correct.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

Q. (By Mr. Short): Your remarks in reference to absence of negligence did you mean them to apply to the other item of \$3,200 in the Jen-Cel-Lite as well?

A. Yes, I did. There is one thing that I would like to add in respect to this salary situation, that I have offered the agent and also the appellate staff the opportunity to assess the corporation disallowing the salary and let Mr. Sayres take a charge back to his account to rectify whatever damage was done by it, but I could not get any agreement.

Mr. Short: I believe that is all. [152]

(Testimony of Harold L. Scott.)

Cross Examination

Q. (By Mr. Cromwell): Mr. Scott, were you present when Mr. Peterson and Mr. Sayres talked about this matter?

A. I can't say offhand that I was. I was present many times when Mr. Sayres was in the office, whether at that time or not I can't answer that.

Q. Then how do you know what went on in Mr. Peterson's mind about this matter?

A. He discussed it with me many times.

Q. When did he discuss it with you?

A. When the agent got into the examination.

Q. Which was several years after this taxable year, is that correct?

A. I was looking at these papers and in Mr. Peterson's writing and I think it was in 1951, November 21, '51, was when I believe that the agent was in on this matter and then at that time it was discussed very thoroughly with all of us.

Q. Did you tell Mr. Miller about Mr. Peterson making these mistakes?

A. Did I tell Miller?

Q. Yes, at the time of the examination?

A. I don't remember of making any direct statement to Miller as to what mistakes Peterson had made, but I know there was a general discussion with Miller as to what had happened. What I said to Miller and what Miller said to me and whether [153] Peterson was there or not, I can't recall at this time. It is five or six years ago.

Q. When did Peterson die, Mr. Scott?

(Testimony of Harold L. Scott.)

A. January 23, 1953.

Q. Did you make the journal vouchers that corrected the amounts of salaries to Mr. Sayres?

A. Did I personally make them?

Q. Yes. A. No, sir.

Q. You stated on direct examination, I believe, that Mr. Peterson didn't go back and look at the books, is that correct?

A. Mr. Peterson did not go to our working papers in our office, our audit papers that we had made examinations of both of these companies, and he did not reconcile the deductions for salaries with Sayres' personal returns.

Q. How do you know he didn't do that, Mr. Scott? A. Because he said he didn't.

Q. Did you discuss this matter with Peterson in anyone else's presence?

A. Yes, I believe I did.

Q. Who was that?

A. I believe Mr. Sayres. I can't say positively, but the matter was an issue of a great deal of discussion and whether I discussed it with the whole office staff or just one or others, I can't answer.

Q. Mr. Scott, did Mr. Sayres ever tell you that if the negligence penalty was assessed in this case that you would have to pay it?

A. Well, he said——

Q. (Interrupting) Yes or no, Mr. Scott?

A. I don't think he said it in exactly that way.

Q. How did he say it?

A. That is what I was trying to explain to you.

(Testimony of Harold L. Scott.)

I think that Sayres felt very definitely there was neglect in our office, that it should have been picked up, and Peterson did not do what he should have done.

Q. Did you supervise Peterson's work, Mr. Scott?

A. Well, Peterson was a partner with me, and I depended upon him a great deal.

Q. Did you supervise his work, Mr. Scott?

A. Oh——

Q. (Interrupting) Yes or no.

A. I can't answer it yes or no. Because it isn't possible. Some of his work, yes, I did very carefully supervise it, other things would happen that he would take charge of and do.

Q. Did you supervise his work with respect to this salary matter of Mr. Sayres? A. No.

Q. You did not?

A. No, I knew nothing of it at all. [155]

Q. Did you advise Mr. Peterson that if you had to pay the negligence penalty that he in turn would have to pay it? A. I did not.

Mr. Cromwell: That is all.

Redirect Examination

Q. (By Mr. Short): Was Peterson a certified public accountant? A. He was.

Q. And was he a partner of yours?

A. Yes, sir.

Q. For how long a period of time?

A. Almost 20 years.

(Testimony of Harold L. Scott.)

Q. Was he normally a reliable, accurate, certified public accountant?

A. He had been for many years.

Q. Did you have confidence in him?

A. I had a great deal of confidence in him.

Mr. Short: That is all.

Mr. Cromwell: No questions.

Mr. Short: That is the petitioner's case, with the exception of this summary, this summary of Mr. Scott's.

Mr. Cromwell: I think, your Honor, that is probably a logical point to stop.

The Court: Off the record.

(Discussion off the record.) [156]

The Court: On the record.

Mr. Cromwell: I think that respondent, in the next few minutes, can proceed with his case on this boat issue and some of these witnesses are being inconvenienced by being here, your Honor.

Call Mr. Ted Jones, please.

Mr. Short: Subject to the summaries to be made by Mr. Scott for the respondent and subject only to the brief testimony of Mr. Harry Botter on Monday in reference to a telephone call from Peterson, subject only to those two items, the petitioner will rest at this time.

The Court: Will the government go ahead with its case?

Mr. Cromwell: Yes, your Honor.

TED JONES

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name and address, please?

The Witness: Ted Jones, 4624 South 170th, Seattle.

Direct Examination

Q. (By Mr. Cromwell): Mr. Jones, what is your business? A. Boat designer.

Q. How long have you been in that business?

A. Earlier it was merely a hobby from 1927, and the last few years it has been my business.

Q. Do you know Stanley Sayres, the petitioner in this case? A. Yes.

Q. How long have you known Stanley Sayres?

A. I think since 1939.

Q. Did you ever design any boats for Mr. Sayres? A. Yes.

Q. What boats did you design?

A. Slo-Mo-Shun III, IV and V.

Q. Did you also build those boats?

A. I built No. III in my basement at home——

Q. (Interrupting) The entire boat?

A. Up to the deck, the bottom and the stanchions which were vital to the speed and performance of the boat, I built those in my home, and the rest of it was done out at Jensen's, the engine installation and the deck and cowlings.

Q. Did you build Slo-Mo-Shun IV or V?

(Testimony of Ted Jones.)

A. Not IV, I engineered No. IV, but I built No. V with the assistance of two, and sometimes three, of Mr. Jensen's boat builders.

Q. Was Slo-Mo-Shun IV entirely your design?

A. Yes, it was.

Q. Was Slo-Mo-Shun V entirely your design?

A. Yes, it was.

Q. These were unlimited hydroplanes?

A. Right.

Q. Have you had occasion to design other unlimited hydroplanes for anyone?

A. Yes, I have.

Q. Will you state briefly who they were?

A. I designed the Breathless for J. Murphy and Miss Thriftway for the Associated Grocers, and the Rebel Suh and Gail VI.

Q. Have you ever designed any boats for Mr. Henry J. Kaiser?

A. I have designed him a hull which is under construction at this time. Also the Wahoo for Bill Boeing, Jr.

Q. Is that Boeing of Boeing Aircraft?

A. Right. And the Shanty for W. T. Wagner of Phoenix, Arizona, and a spare hull for the two of them, and I have redesigned the Gails, Such Crust, Temple, the Supertes.

Q. Who owns the Temple?

A. Guy Lombardo.

Q. And who owns the Gails?

A. Joe Shaneth.

Q. And the Such Crusts?

(Testimony of Ted Jones.)

A. Jack Shafer.

Q. Of what is Mr. Shafer? [159]

A. Detroit.

Q. Have you ever been written up in any national magazines?

A. A good many times, yes.

Q. Will you tell us for instance, which ones?

A. Well, the last——

Q. (Interrupting) Just the ones that come to your mind at this time.

A. In Sports Illustrated and in True and in Yachting, Motor Boating, Sea, Pacific Motor Boat, a good many others I don't recall.

Q. Are you a member of the American Power Boat Association? A. I am.

Q. Are you a member of the American Power Boat Association as an owner or as a driver?

A. Owner and driver.

Q. What is the—do you own an unlimited hydro-plane that you race?

A. I have a half interest in Rebel Suh.

Q. Have you raced that boat in any Gold Cup races?

A. No, I haven't, I had it raced this last year by Colonel Shay, I was too busy to drive it.

Q. How long have you been a member of the American Power Boat Association? [160]

A. I think since 1934 or '35.

Q. I hand you Petitioner's Exhibit 5, which is entitled, "Propeller, American Power Boat Association, 1956 Rule Book." Will you examine that

(Testimony of Ted Jones.)

and tell me if that rule book is the same that is the rule book, assuming they had a rule book in 1950, is that the same as that?

A. It is the same size, it has the same prefixes here.

Q. To your knowledge do you know if the rules have changed between 1950 and 1956, the American Power Boat Association rules?

A. Oh, the rules change constantly in some small amounts.

Q. So the rules according to this book, would not necessarily be the rules according to the book that was issued in 1950?

A. Not necessarily.

Q. Or 1949, for instance?

A. No, they change with the boats and the speeds and conditions.

Q. I hand you Petitioner's Exhibit 1, which is entitled "Agreement", dated July 17, 1950, and I refer you to page 2, is that your signature?

A. It is.

Q. Will you explain just what, under what conditions you signed this contract?

A. Well, it turned out that—— [161]

Mr. Short (interrupting): I object to the materiality of this. It is a pretty broad answer by the witness. I don't know whether the witness understands the question.

Mr. Cromwell: I will rephrase the question.

Q. (By Mr. Cromwell): Did you sign this contract on July 17, 1950? A. Yes, I did.

(Testimony of Ted Jones.)

Q. Under what circumstances did you sign this contract, Mr. Jones, on July 17, 1950?

A. I was in Mr. Sayres' office.

Q. Here in Seattle? A. Yes.

Q. Have you ever built any boats under this contract?

A. I built Slo-Mo-Shun V, I started the boat in February, the latter part of February, in 1951, so apparently—and that was signed in '50. Oh, yes, I did.

Q. You have no other agreement for building that boat, Slo-Mo-Shun V?

A. No, other than an oral stated agreement.

Q. How long did you operate under this contract, Mr. Jones?

A. Until, I think it was the first part of November of 1951. It might have been the latter part of October.

Q. Was that after you finished the Slo-Mo-Shun V?

A. Oh, yes, and after we had campaigned it for the year [162] of 1951.

Q. Why didn't you build other boats under this contract for Mr. Sayres for the parties of the first part?

A. It would have been for Mr. Sayres had he wanted any more. And we just completed No. V by the end of July, 1951, and that took care of the racing season for that year, and no other boats were discussed.

(Testimony of Ted Jones.)

Q. Was that built—was Slo-Mo-Shun V built for the, to go into the Gold Cup race in 1951?

A. That was our deal, yes, to get it completed and running for the 1951 Gold Cup.

Q. Did you build any other boats while this contract was in effect for anybody else?

A. No, I didn't.

Q. Why didn't you, Mr. Jones?

A. I felt obligated to it, if I had signed it, then, I was going to carry through with it.

Q. Did you not build any more boats under this contract because of some disagreement with Mr. Sayres?

A. Well, the boats would have to have been built for Mr. Sayres and he didn't need any more at that time. I didn't design them for anyone else, then, until I think January of 1954, I let almost three years or roughly three years, go by.

Q. Did you have an opportunity to build boats for anyone else?

A. Oh, a good many. [163]

Q. Were you approached?

A. Yes, I was.

Q. And why didn't you build those boats?

A. Due to the restraint of the contract.

Q. Then you considered that a restraining contract?

A. I feel that it is, yes, or was.

Q. Can you mention some of the people who approached you to build boats during the period of this contract, during the period this contract was in effect?

A. Howard Keck of Los Angeles, President of

(Testimony of Ted Jones.)

Superior Oil Company, and Mr. Horace Dodge, Jack Shafer, Joe Shaneth, Gordon Thompson of Canada, two other men in Canada whose names I don't recall. There were others whom I can't remember at this time.

Q. Did you approach Mr. Sayres and ask him if you could build those boats?

A. I did in July of 1950, July 21st or 24th, right after the Gold Cup race. Horace Dodge wanted two boats built at that time for a very good figure.

Q. What was that figure?

A. \$50,000 per boat.

Q. What did Mr. Sayres tell you?

A. That we wouldn't be building for anyone.

Q. Did he tell you why?

A. Well, I would have to assume so that there would be [164] no more boats in Slo-Mo-Shun's speed and maneuverability for competition. That was what I gathered from the conversation.

Q. Now, considering the physical structure of the Slo-Mo-Shun IV and Slo-Mo-Shun V, could these boats be used on rough water?

A. Yes, for their size they are exceptionally seaworthy and built very sturdily for rough water usage. You might define how rough.

Q. Such water that perhaps as the Navy would use them in an open sea, as P-T boats would be used.

A. Not under the 28-foot length of the hulls, but if the length of the hulls were stretched out to

(Testimony of Ted Jones.)

possibly 50 feet, they would be as seaworthy as any 50-foot conventional designed P-T boat.

Q. How long is the Slo-Mo-Shun IV-

A. Twenty-eight foot.

Q. How long is the Slo-Mo-Shun V?

A. Twenty-eight foot also. The only difference between the two is their width, Slo-Mo V is seven inches wider.

Mr. Cromwell: Respondent has completed his direct examination.

Cross Examination

Q. (By Mr. Short): Mr. Jones, I take it that when you and Mr. Sayres signed this agreement, Exhibit 1, you were anticipating what [165] would happen in the event of a sale either of the boats of the design or of the class that you had designed, or of the plans for those boats, were you not?

A. Yes.

Q. That is the arrangement provided for for you in that agreement? A. That is right.

Q. Did you and he anticipate that that might be a likelihood, that is to say, that the design may be in demand for boats produced——

A. (Interrupting) My entire life has been devoted to come up with something extremely fast in the water, and I was very sure that when it was proven that it would finally pay off?

Q. And be profitable? A. Right.

Q. And you ultimately have made that your career, have you not? A. That is right.

(Testimony of Ted Jones.)

Q. And these boats that you have referred to as being designed by you for various people throughout the country are on this principle of the IV and V, are they not? A. Yes, they are.

Q. And at the time that that design was perfected in IV and V, it was a revolutionary design in reference to the [166] construction of unlimited hydroplanes which preceded it, is that right?

A. As far as the unlimited, yes, but it was identical to my limited boats that I had been racing for a good many years.

Q. You were interested and prompted, I take it, by, and are now, are you not, by profit incentive as well as a natural interest in the subject, are you not? A. Yes.

Q. Do you now make your living or is your income now solely derived from this pursuit?

A. It is.

Q. You have indicated that on July 24, 1950, it was suggested to you—it was suggested by you to Sayres, that you had available the offer to construct two such boats for \$50,000 each?

A. Right.

Q. The contract, Exhibit 1, was signed seven days before that? A. Yes, it was.

Q. Is there any relationship between those two instances? A. What?

Q. I mean is it pure coincidence that on July 17th you signed the contract to build boats exclusively for the American Properties and Sayres, and on July 24th you were asking permission [167] to

(Testimony of Ted Jones.)

build them for someone else, is there any coincidence there?

A. Yes, there is. The Gold Cup race was on July 22nd, and the concensus of opinion of all eastern boat owners and drivers was that the Slo-Mo-Shun couldn't survive the water, and the supreme test for the boat would come during the Gold Cup race, and it came through in very fine shape and immediately I was besieged with these persons wanting duplicate boats.

Q. And as a matter of fact, before that—well, before IV set the record in January of that year, there was a good deal of derision about this hull design, was there not? A. Yes.

Q. That it was a back yard freak of some kind?

A. That is what we liked to call it.

Q. The Detroit people? A. Yes.

Q. In August of 1949 is it a fair statement to say that at least you and Sayres, possibly Jensen at that time, were quite enthusiastic that this design was going to do something remarkable?

A. I was convinced.

Q. Had you convinced Sayres, too?

A. I think I had.

Q. Without getting into the detailed matter isn't it a fact that, Mr. Jones, that prior—that certain differences developed between you and Anchor Jensen? [168]

A. That is true. He had never built or raced a race boat before, he was a very fine cruiser and sailboat builder and his preference was for the old

(Testimony of Ted Jones.)

type single step or double-step hydroplane, and he constantly told me that——

Q. (Interrupting) I don't care about the subject matter. I just am curious about the fact as to whether or not there was a certain difference between you and him? A. Yes, there was.

Q. Had that progressed—that got worse over a period of time, did it not?

A. Yes, he wanted the boat heavy and I wanted it light.

Q. Was there a draft of an agreement prepared preceding this Exhibit 1, that you ultimately signed which had Anchor in it? A. Yes, there was.

Q. And I take it that was not executed by all parties?

A. I don't understand that question.

Q. By all of the parties, that is you and Anchor and Mr. Sayres, on behalf of American Properties, did not sign that agreement that had you all in it?

A. No, no, I didn't sign it.

Q. When did you go east, did you say—well, state it again, will you?

A. When did I go east?

Q. Yes. [169] A. To race the Gold Cup?

Q. No, when would you say that you parted company with American Properties and Sayres and Jensen and went on your own?

A. I think it was around the first of November, 1951.

Q. Can you state what the rule of the American

(Testimony of Ted Jones.)

Power Boat Association was in 1949 as to ownership and entry? A. No, I can't.

Q. You can't state, then, whether Exhibit 5, those rules you looked at, insofar as Rule 3 is concerned, pertaining to ownership and entry of unlimited class boats, whether that is now the same as it was in 1949?

A. I couldn't tell you.

Mr. Short: I think that is all.

Mr. Cromwell: Respondent has no further questions.

The Court: Thank you. You are excused.

(Witness excused.)

Mr. Cromwell: Respondent rests so far as this phase of the case is concerned, concerning the boat issue.

Mr. Short: Mr. Sayres, will you take the stand for a brief moment, please.

STANLEY S. SAYRES

called as a witness in rebuttal on behalf of the petitioner, having been previously sworn, testified further as follows:

Mr. Cromwell: Pardon me, your Honor, I think we can excuse all of the witnesses except perhaps Mr. Jones, and [170] I ask Mr. Jones to remain for just a few minutes.

Direct Examination

Q. (By Mr. Short): Mr. Sayres, are you ac-

(Testimony of Stanley S. Sayres.)

quainted with whether or not the rule on ownership and entry has changed since 1949?

A. No, it is exactly the same as it was.

Q. Would you state whether or not—well, I better hand you the exhibit. I show you Exhibit 1, and direct your attention to paragraph 8, which is on the end of that agreement. I will ask you whether or not the notice provided for therein was ever given either by you to Jones or by Jones to you?

A. No.

Q. I didn't hear your answer.

A. No.

Mr. Short: That is all.

Mr. Cromwell: No questions.

The Court: You are excused.

(Witness excused.)

Mr. Short: That is the end of rebuttal.

The Court: Do both parties rest except for the reservation that we had in the record a half hour ago?

Mr. Short: That is correct.

Mr. Cromwell: That is right.

The Court: Is it possible?

Mr. Short: May I suggest, if the Court please, I am [171] advised by Mr. Scott that he consulted with the respondent about getting together with the respondent at 8:30 on Monday morning and in approximately an hour and a half they could conclude and have something ready in which case I would suggest that we commence at 10 o'clock if that meets with your views on it.

Mr. Cromwell: That is satisfactory as far as respondent is concerned.

The Court: There were three things, there was the matter of this exhibit to be prepared from the records, the matter of the testimony of the one witness, and the—something about a deposition.

Mr. Short: I doubt you want a deposition.

Mr. Cromwell: No, no.

Mr. Short: Royal Brougham articles are all in now.

Mr. Cromwell: They are in, your Honor.

Mr. Short: So there are just those two items to complete the proof.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

We will recess until 9:30 Monday morning.

(Whereupon, at 5:30 o'clock p.m., an adjournment was taken until 9:30 a.m. Monday, April 21, 1956.) [172]

* * * * *

Court of Appeals, U. S. Courthouse, Seattle, Washington, May 21, 1956.

* * * * *

The hearing in the above-entitled matter was convened at 9:30 a.m. before

The Honorable Craig S. Atkins, Presiding.

Appearances: Kenneth B. Short, Esq., and Tracy Griffin, Esq., and Harold L. Scott, Esq., on behalf of the Petitioner. Gordon M. Cromwell, Esq., on behalf of the Respondent.

Proceedings

The Clerk: We will proceed with the case on trial, Docket 57748, American Properties, Incorporated, and related cases.

Mr. Cromwell: First, your Honor, I would like to say that I neglected to ask the Court Friday for permission to withdraw original exhibits put in by the Respondent and substitute photostats, and I now make that request.

The Court: Any objection?

Mr. Short: No. I wonder if the Petitioner may do likewise? We have our original resolution.

The Court: That is agreeable with you?

Mr. Cromwell: That is agreeable.

The Court: Originals may be withdrawn and photostatic copies submitted of all the exhibits that you want to substitute.

Mr. Cromwell: A dispute arose Friday with regard to the expenditures, the amounts paid by the corporation, American Properties, Incorporated, in 1949 and 1950, on the building, maintenance and operation of these boats.

We have gotten together briefly this morning, and the Respondent is now willing to stipulate that it agrees that the amounts shown on Respondent's Exhibit A, which is entitled, "Reconciliation of Expenses disallowed in computing net income of American Properties, Incorporated, for calendar years 1949 [176] and 1950, and included as additional income to Stanley S. and Madeleine A. Sayres, in fiscal years ended October 31, 1949 and 1950."

That exhibit, so entitled, at the bottom carries a summary entitled, "Adjustments to income of Individuals." The totals of those columns are the amounts that the Respondent is willing to stipulate were expended by American Properties, Incorporated, the tax years 1949 and 1950, respectively, in the building or maintenance and operation of the boats in question.

For the purposes of the record, I will stipulate those amounts.

The total amount expended by American Properties, Incorporated, in 1949, as shown by Exhibit A, is \$16,401.51. The total amount expended by American Properties, Incorporated, for 1950, is \$16,595.31. It is these two amounts which Respondent now stipulates were expended by American Properties, Incorporated, in the respective years, in the building or maintenance and operation of the boats in question.

The Court: Is that agreeable with counsel for the Respondent?

Mr. Short: Yes, sir, it is.

Mr. Cromwell: I have one witness to call on the salary question, unless Petitioner——

Mr. Short (interrupting): I still have, you know, [177] Mr. Potter, and, as I indicated to the Court, I have a couple of minutes with him. I don't know whose move it is. I have forgotten the status, whose case it is.

Mr. Cromwell: You may proceed.

HARRY POTTER

was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you please state your name and address, Mr. Witness?

The Witness: Harry Potter, 1715 North 107th Street, Seattle 33.

Direct Examination

Q. (By Mr. Short): What is your occupation, Mr. Potter?

A. Office manager and treasurer, American Automobile Company.

Q. How long have you been in that capacity?

A. Well, office manager since 1941, treasurer since about '47, I believe.

Q. Did you ever have a request from a Mr. Peterson of Harold Scott & Company for information relative to Sayres' salary with American Auto for 1949? A. Yes.

Q. Do you have a recollection as to when that call was [178] made?

A. Not definitely. It was at the time when Mr. Peterson was preparing Mr. Sayres' return for his '49 year, it ended October 31, 1949, and it was sometime after that, I don't know just when it was.

Q. Do you recall what the request was?

A. Yes. Mr. Peterson called and asked, or told me, that he had all of the data necessary to complete Mr. Sayres' return except his salary, and

(Testimony of Harry Potter.)

would I please tell him what the salary was, which I did.

Q. What did you tell him?

A. \$3,500 per month.

Mr. Short: That is all.

Mr. Cromwell: No questions.

(Witness excused.)

Mr. Short: Mr. Sayres.

STANLEY S. SAYRES

recalled as a witness by and on behalf of the petitioner, having been previously sworn, testified further as follows:

The Clerk: Mr. Sayres has already been sworn.

Redirect Examination

Q. (By Mr. Short): Showing you what has been admitted in evidence as Respondent's Exhibit A, I will ask you whether or not you personally supervise the expense of the construction and maintenance [179] and operation of Slo-Mo-Shun?

A. Yes.

Q. Are you acquainted with the figures that appear on that exhibit? A. Yes.

Q. Are the items of capital expenditure, maintenance and operation of those boats——

Mr. Cromwell (interrupting): Your Honor——

The Court: (interrupting): Finish the question.

Q. (By Mr. Short): ——each of them necessary and reasonable expenses for the construction and operation of the boat?

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: If we are going into that evidence, we will have to put the books and records into evidence, so I will have a chance to cross-examine the witness on them. I haven't stipulated to the records, I have stipulated to the total amounts.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

As I understand the government's contention, it has disallowed these expenses as ordinary and necessary expenses of the corporation, and that probably the burden is on the taxpayer to show that they are. The present question calls for a conclusion of the witness which may be of vital help to [180] the Court in deciding that. However, I am willing to take his statement. I therefore overrule the objection, but I would suggest that you might want to fortify it for the purposes of clarifying the record on the reasonableness of these expenses.

Mr. Cromwell: Respondent notes an exception to that ruling, your Honor.

The Court: The exception will be noted.

Q. (By Mr. Short): Will you answer the question now, Mr. Sayres.

A. Well, yes. Should I answer it in my own way?

Q. Yes.

A. The expenses certainly are ordinary and necessary if we were going to accomplish anything.

(Testimony of Stanley S. Sayres.)

When you build a boat, you either have to have the engine right and the gear box right, and the struts right, and rudder has to be right, and the steering system, or the boat's a failure, and certainly there is no expense that went into that picture, neither at that time nor since, that was anything but very necessary, very much a part of the operation of the boats.

Q. Did actually more items of expense go into the boat than appears on that exhibit?

Mr. Cromwell: That is a leading question. I object to that question, your Honor.

The Court: Do you withdraw it?

Mr. Short: Yes. [181]

Q. (By Mr. Short): Do you have Exhibit A before you now, Mr. Sayres? A. Yes.

Q. In reference to that item A, "Gasoline and oil"? A. Yes.

Q. Did you use regular gasoline as you buy at a gas station? A. No.

Q. Without getting into the chemical specifications, did you make special arrangements to procure that?

A. Yes, at that time, that is, that is what was called 115, 140 octane, and I arranged to get that through Standard Oil Company this year, or these two years.

Q. This item appearing as "Travel expenses", about six or seven items down, do you see that?

A. Yes. That was the cost of taking the crew to Detroit preparatory to running the 1950 Gold

(Testimony of Stanley S. Sayres.)

Cup race. It also involved bringing the crew back home from Detroit, and then returning a little over a month later to run the Harmsworth.

Q. Same crew? A. Same crew.

Q. How many people did that consist of, on that move? A. I had six men.

Mr. Short: That is all. [182]

Recross Examination

Q. (By Mr. Cromwell): What is your definition of "Ordinary and necessary expense"?

A. My definition is the things you had to do to make it successful.

Q. What successful? A. The boat.

Q. In what respect?

A. Well, it's pretty much a matter of record, it set a world straightaway record, it won the Gold Cup and it won the Harmsworth that year.

Q. Regarding the travel expense question, you have Exhibit A there before you? A. Yes.

Q. I wonder if you will tell us there in that first column, what the \$5,229.27 represents. Just how much does that represent, as far as hotel bills are concerned, for instance?

A. In hotel bills, the crew and myself were in Detroit, I think, about roughly seven days at the time of the Gold Cup race, and I think we were there perhaps eight days at the time of the Harmsworth, and if you take six men, plus my own, as I recall it, we paid the Whittier Hotel rates around

(Testimony of Stanley S. Sayres.)

\$10 or \$12 a day, that was about, and I had to feed them, of course, so that would take quite a bit.

Q. To what extent does this represent train fare? [183]

A. Whatever the, they all, as I recall it, they all went to Detroit by air, and the over-all expense was lessened a little by one or two of them driving a new car back.

Q. What was the dollar figure expended in transportation?

A. Let's put it this way, as I recall it, the one-way airplane fare from here to Detroit is around \$130, I may be wrong in that, but it's somewhere in that general neighborhood, and some of them had a round trip, and, mind you, there's two trips involved, they went to Detroit and returned to Seattle, and then to Detroit again, and they had to come back, so I think there is a sum running in there around a thousand and two hundred dollars, perhaps.

Q. Did you take Mrs. Sayres with you?

A. Yes, I did.

Mr. Short: I would like this marked.

The Clerk: Exhibit 10 for identification.

(Petitioner's Exhibit 10 was marked for identification.)

Q. (By Mr. Short): Mr. Sayres, I am handing you what has been marked for identification as Petitioner's Exhibit 10. In reference to the last question asked you about Mrs. Sayres, can you tell us what that exhibit is? A. Oh—

(Testimony of Stanley S. Sayres.)

Q. Is that your handwriting? [184]

A. Yes, it is.

Q. What is that sheet supposed to be?

A. Gold Cup expense paid by personal check, here and there, I wrote my personal check, and then it was charged back to the company. The last item, air travel expense. Mrs. Sayres charged to S. S. Sayres personally.

Mr. Cromwell: Will you put that in evidence?

Mr. Short: Exhibit 10, I offer Exhibit 10.

Q. (By Mr. Cromwell): Did you prepare this?

A. Yes.

Q. When did you prepare it?

A. I couldn't answer that right now. I don't know.

Q. Was it made at the time that these expenses were incurred?

A. Well, undoubtedly after I returned.

Q. But not at the time the expenditures were made?

A. Let me see it again, please. That was made immediately after the Harmsworth race, that finished up on 8-2.

Q. Immediately after the Harmsworth race?

A. Yes.

Q. 8-2, what, 1950? A. 1950.

Q. And when was the Gold Cup race?

A. July 22nd. [185]

Mr. Cromwell: Your Honor, Respondents object to Petitioner's Exhibit 10 marked for identifi-

(Testimony of Stanley S. Sayres.)

cation, on the basis it wasn't made contemporaneous with the occurrence of the expenditures.

The Court: I don't think it has been offered, has it?

Mr. Short: I offer it now, yes. I offer it for the purpose of showing that it is a directive to someone who maintains the records. It's for the last entry on that sheet, directing—or last two entries, directing that the expense of Mrs. Sayres' flight to Detroit and back be charged to S. S. Sayres individually, and not to either American Auto or American Properties.

Mr. Griffin His expenses were charged to American Auto.

Mr. Short: Yes.

You see, in the entry before that, it charges his own flight to American Auto, and not to American Properties.

The Court: Show me that, will you, please?

Mr. Short: This is Mrs. S. S. Sayres to S. S. Sayres personally, S. S. Sayres to American Auto, and the rest is to American Properties, Inc. It's in reference to the question asked him by counsel whether or not Mrs. Sayres went with him, leaving the inference that that got charged to American Properties.

The Court: As I understand it, Mr. Sayres, you made [186] this within what time after you, after the expenses were incurred?

The Witness: Oh, just about as soon as I got

(Testimony of Stanley S. Sayres.)

home, shortly after I got home, I picked those right out of my personal check book.

The Court: Do you know of your own knowledge that Mrs. Sayres' expenses were charged to you personally?

The Witness: Yes.

The Court: I should think that your word would be sufficient on that.

I will receive this as being contemporaneous.

Objection overruled.

(Petitioner's Exhibit 10 was received in evidence.)

Mr. Cromwell: No further questions.

Mr. Short: I have a few more brief questions for Mr. Sayres.

Redirect Examination

Q. (By Mr. Short): In 1950, Mr. Sayres, you then had—will you state again, so we get ourselves oriented, when the Slo-Mo-Shun V was built?

A. No. V was built in 1951.

Q. In 1950 there was in existence Slo-Mo-Shun III and IV? A. That is right. [187]

Mr. Cromwell: That is a leading question.

Mr. Short: Without establishing the dates.

Q. (By Mr. Short): What boats did you have in existence in 1950?

A. Slo-Mo-Shun III and Slo-Mo-Shun IV.

Q. At that time what was the life expectancy of Slo-Mo-Shun III?

A. Well, many race boats are pretty well done

(Testimony of Stanley S. Sayres.)

up within two years. I felt both these hulls were of very sound construction, and it was my own opinion they were good for at least four years.

Mr. Short: That is all.

The Court: You are speaking of the physical life?

Mr. Short: Physical life, yes.

Let me put it this way.

Q. (By Mr. Short): The life of the boats for the use to which they were put was how long? Is that your answer?

A. Yes, that is what I mean.

Recross Examination

Q. (By Mr. Cromwell): Do you mean their racing life, Mr. Sayres? A. Yes.

Mr. Cromwell: That is all.

Mr. Short: That is all.

We rest. [188]

(Witness excused.)

Mr. Cromwell: I would like to call Mr. Miller, please.

GEORGE MILLER

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Please state your name and your address.

The Witness: My name is George Miller, 5717 37th Avenue Northeast, Seattle.

(Testimony of George Miller.)

Direct Examination

Q. (By Mr. Cromwell): What is your occupation?

A. I am an internal revenue agent.

Q. How long have you been an internal revenue agent? A. Nine years.

Q. During your course of employment as an internal revenue agent did you ever have the occasion to examine the records of Stanley S. Sayres and Madeleine A. Sayres? A. Yes, sir.

Q. For what years?

A. The fiscal years ending 10/31/48, 10/31/49, 10/31/50.

Q. Was that in connection with an examination of their income tax returns for those years?

A. Yes.

Q. Did your examination include the examination of any [189] books or records of any corporations? A. Yes, sir.

Q. What corporations?

A. The American Properties, Incorporated, and the American Automobile Company.

Q. Were those corporations of Mr. Sayres'?

A. Yes, sir.

Q. Did you examine the pay roll records of American Automobile Company for the year 1948 to determine what salaries, if any, were credited to Mr. Sayres during his taxable year 1948?

A. Yes, sir.

Q. Did the pay roll records of American Auto-

(Testimony of George Miller.)

mobile Company disclose any salary credited to Stanley Sayres in his tax year 1948?

A. Yes, sir.

Q. How much? A. \$48,000.

Q. Did the record of American Automobile Company disclose any income taxes withheld on salary credited to Stanley Sayres in his tax year 1948? A. Yes, sir.

Q. Did you transcribe the pay roll records of American Automobile Company by month as to salaries credited to Stanley Sayres during the tax year 1948? A. Yes, sir. [190]

Q. Did you also transcribe from the pay roll records of American Automobile Company month by month as to income taxes withheld on those salaries credited to Mr. Sayres in 1948?

A. Yes, sir.

Q. Have you had a copy typed, that was prepared from that transcription? A. Yes, sir.

Mr. Cromwell: I would like this marked, please.

The Clerk: Exhibit W for identification.

(Respondent's Exhibit W was marked for identification.)

Q. (By Mr. Cromwell): I hand you Respondent's Exhibit W marked for identification and ask you if that is a typed copy of the transcriptions of the payroll records, made by you from American Automobile Company's books, of Mr. Sayres' salary for his taxable year 1948? A. Yes, sir.

Q. Does it also include other taxable years?

A. Yes, it does.

(Testimony of George Miller.)

Q. Does it include the years 1946 through 1950, inclusive? A. Yes, sir.

Q. Referring to page 2 of Respondent's Exhibit W marked for identification, I ask you what that is, Mr. Miller.

A. It's a recapitulation of the amounts taken as income tax withheld on Mr. Sayres' return.

Q. What is the bottom of this?

A. It's a reconciliation between the income tax withheld records of the American Automobile Company, and that as reported on the returns of Mr. Sayres and Mrs. Sayres.

Mr. Cromwell: I offer Respondent's Exhibit W, marked for identification, in evidence, your Honor.

Mr. Short: No objection.

The Court: It may be received.

The Clerk: Exhibit W.

(Respondent's Exhibit W was received in evidence.)

Q. (By Mr. Cromwell): Handing you Respondent's Exhibit W, Mr. Miller, referring to November, under the schedule 1947, referring to the heading, "1947" and down in the second column, or in the second portion, of page 1 of that exhibit, under, "Salaries", for the months of November and December, 1947, the total amount of \$5,000, credited to Mr. Sayres' salary account, is that what you found to be credited to his account?

A. That is correct.

Q. On the salary account?

A. That is correct.

(Testimony of George Miller.)

Q. On the books of American Properties, Incorporated? A. Yes, sir.

Q. Referring to the next column, under "1948", the bottom [192] of the column says, "\$43,000". Will you tell the Court what that represents?

A. The \$43,000 represents the salary credited to Mr. Sayres' account from January 1, 1948, to October 31, 1948. It's for the months of January to October, inclusive.

Q. How many months is that, in that period?

A. Ten months.

Q. Referring back to the months of November and December, 1947, where the total amount you found credited to Mr. Sayres' salary is \$5,000, \$5,000 plus the \$43,000 is how much?

A. \$48,000.

Q. You found that total amount credited to Mr. Sayres' salary account? A. Yes.

Q. For 1948, on the books of American Properties?

A. For the fiscal year ending 10/31/48.

Q. In that same column, on Exhibit W, opposite the month of "April" is an item of "\$12,000". Will you explain to the Court what that is?

A. That represented an additional entry to the books of \$12,000 covering salary, which is a part of the \$43,000. It is represented in a journal voucher.

Q. When did you find that was credited to Mr. Sayres? A. As of April 30, 1948.

Q. Did you find from your examination of the

(Testimony of George Miller.)

pay roll [193] record of American Automobile Company a deduction for income tax withheld on that \$12,000 item just referred to?

A. Yes, I did.

Q. What, how much was the credit for the tax withheld on that amount? A. \$1,800.

Q. Referring to page 2 of Respondent's Exhibit W, which is a recapitulation of the figures on the first page, under the heading, "Total amount withheld, \$7,459.80", does that include the \$1,800 on the \$12,000 item? A. Yes.

Q. In examining the separate tax returns of Stanley and Madeleine Sayres for 1948, did you find that between them they had taken full credit for income taxes withheld by American Automobile Company on salary credited to Mr. Sayres in that year?

Mr. Short: I object to the leading nature of the question.

The Court: I don't see that it's leading.

A. Yes, they took full credit for the taxes withheld.

Q. (By Mr. Cromwell): Did they take full—was that the full credit for the taxes withheld on the \$48,000? A. Yes.

Mr. Cromwell: Respondent has no further questions. [194]

Cross Examination

Q. (By Mr. Short): Would the W-2, or withholding tax memorandum furnished by the corporation to either of these taxpayers, during any

(Testimony of George Miller.)

year in which the salary of Mr. Sayres changed, agree with the actual amount received by Sayres for that year?

A. It can be reconciled to it, yes.

Q. That isn't what I asked you.

Mr. Short: Read the question.

(Second preceding question read.)

The Court: That is a rather hard question, isn't it?

(Second preceding question reread.)

Q. (By Mr. Short): Received or reported. Can you answer that?

A. Did you say, "Did they" or "Could they"?

Q. Were they the same?

A. No, they weren't.

Q. And the reason they are not the same is the difference in the reporting years of the corporation and the individual?

A. That is right.

Q. In examining—you stated that you had made examination not only of the records of the taxpayers Stanley and Madeleine Sayres, but of American Properties and American Auto, is that correct?

A. The pay roll records of the American Automobile.

Q. The what? [195]

A. The pay roll records of the American Automobile.

Q. Did you examine the resolutions of that corporation to determine what salary had been authorized to Sayres for either of those taxable years?

A. I cannot recall.

(Testimony of George Miller.)

Q. Is that the ordinary practice in making an examination of that type, salary examination?

Mr. Cromwell: To what are you referring?

Mr. Short: To examining the resolutions or other authority authorizing the salary.

A. Not necessarily.

Q. (By Mr. Short): Would you say that you did or did not examine the resolutions in this instance? A. I cannot recall. I am sorry.

Mr. Short: That is all.

(Witness excused.)

Mr. Cromwell: Respondent rests, your Honor.

Mr. Short: Petitioner rests, your Honor.

The Court: How about the briefs?

Mr. Cromwell: Simultaneous briefs would be what I prefer, your Honor.

Mr. Short: I think simultaneous briefs would be probably all right.

About 90 days? [196]

Mr. Cromwell: That suits me.

The Court: How about reply briefs?

Mr. Cromwell: 45 days.

Mr. Short: That is plenty of time.

The Clerk: Would you like those dates, gentlemen?

Mr. Cromwell: Yes, please.

Mr. Short: Yes.

The Clerk: The date will be August 20th for original briefs and on or before October 4th for reply briefs.

Mr. Short: That is the filing date, I assume?

The Court: Very well.

The case will stand submitted upon filing of the briefs.

Court will recess for about 15 minutes.

(Whereupon, at 10:35 o'clock a.m., the hearing in the above-entitled petition was closed.)

[Endorsed]: T.C.U.S. Filed June 6, 1956.

[Title of Tax Court and Docket Nos. 57748 and 57751.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 13, inclusive, constitute and are all of the original papers on file in my office as called for by the Designation of Contents of Record, except the original exhibits, admitted in evidence, which are separately certified, in the cases before the Tax Court of the United States docketed at the above numbers and in which the petitioners in the Tax Court have filed a petition for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court cases, as the same appear in the official docket of my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United

States, at Washington, in the District of Columbia,
this 2nd day of June, 1958.

[Seal]

HOWARD P. LOCKE,
Clerk, Tax Court of the
United States.

[Endorsed]: No. 16051. United States Court
of Appeals for the Ninth Circuit. American Prop-
erties, Inc., and The Estate of Stanley S. Sayres,
deceased, Harold L. Scott and A. R. Munger, Ex-
ecutors, and Madeleine A. Sayres, Petitioners, vs.
Commissioner of Internal Revenue, Respondent.
Transcript of the Record. Petition to Review a
Decision of The Tax Court of the United States.

Filed: June 10, 1958.

Docketed: June 18, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

United States Court of Appeals
For The Ninth Circuit

No. 16051

AMERICAN PROPERTIES, INC., and the
ESTATE OF STANLEY S. SAYRES, De-
ceased, HAROLD L. SCOTT and A. R.
MUNGER, Executors, and MADELEINE A.
SAYRES, Petitioners on Review.

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

STATEMENT OF POINTS

Come Now Petitioners On Review and make the following Statement of Points upon which they rely upon this Petition for Review:

1. The Tax Court erred in holding that the expenditures made by petitioner, American Properties, Inc., in 1949 and 1950 in connection with designing, constructing and racing of unlimited class hydroplanes did not constitute deductible business expense of the corporation.

2. The Tax Court erred in holding such expenditures to be personal hobby expenses of the corporation's sole stockholders, Stanley S. Sayres and Madeleine A. Sayres, and taxable income to said stockholders.

3. The Tax Court erred in determining deficiencies as to each petitioner in consequence of the foregoing findings.

4. The Tax Court erred in finding that the activities of petitioners with respect to the boats were not conducted with the intent of making a profit and that they did not constitute the conduct of a trade or business by any of petitioners.

/s/ KENNETH P. SHORT,
Attorney for Petitioners on
Review.

[Endorsed]: Filed June 18, 1958. Paul P.
O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

STIPULATION FOR CONSIDERATION OF EXHIBITS WITHOUT REPRODUCTION

It is stipulated between counsel for the respective parties that the exhibits heretofore transmitted to the Court in their original form by the Clerk of the Tax Court of the United States may be considered by the above entitled Court in their original form without reproduction.

Dated this 7th day of July, 1958.

/s/ KENNETH P. SHORT,
Attorney for Petitioners on Review.

/s/ CHARLES K. RICE,
Assistant Attorney General, Attorney for Respond-
ent on Review.

[Endorsed]: Filed July 9, 1958. Paul P.
O'Brien, Clerk.

No. 16051

United States Court of Appeals
For the Ninth Circuit

AMERICAN PROPERTIES, INC., and the Estate of STANLEY
S. SAYRES, Deceased, HAROLD L. SCOTT and A. R.
MUNGER, Executors, and MADELEINE A. SAYRES,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR REVIEW OF DECISION OF THE TAX COURT
OF THE UNITED STATES
HONORABLE CRAIG S. ATKINS, *Judge*

BRIEF OF PETITIONERS ON REVIEW

KENNETH P. SHORT
Attorney for Petitioners on Review.

1107 American Building,
Seattle 4, Washington.

THE ARGUS PRESS, SEATTLE

FILED

SEP 29 1958

United States Court of Appeals
For the Ninth Circuit

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United States Court of Appeals

For the Ninth Circuit

AMERICAN PROPERTIES, INC., and the Estate of STANLEY S. SAYRES, Deceased, HAROLD L. SCOTT and A. R. MUNGER, Executors, and MADELEINE A. SAYRES, <i>Petitioners,</i>	} No. 16051
vs.	
COMMISSIONER OF INTERNAL REVENUE, <i>Respondent.</i>	

PETITION FOR REVIEW OF DECISION OF THE TAX COURT
OF THE UNITED STATES
HONORABLE CRAIG S. ATKINS, *Judge*

BRIEF OF PETITIONERS ON REVIEW

JURISDICTION

The Tax Court of the United States acquired jurisdiction of these consolidated causes by the petitioners having filed in that court their respective petitions for redetermination of deficiencies in income tax (Tr. 3 to 10, 13 to 23). Jurisdiction in the Tax Court of such causes is conferred by 26 U.S.C. 6213 and 26 U.S.C. 7442.

Jurisdiction to review the decisions of the Tax Court of the United States is conferred upon this court by 26 U.S.C. 7482.

STATEMENT OF THE CASE

The petition of American Properties, Inc., filed in the Tax Court under its Docket No. 57748, sought a redetermination of deficiencies asserted by the Commissioner in income taxes for the calendar years 1949 and 1950 and asserted (Tr. 3 to 6) error of the Commissioner "in disallowing for the year 1949 the cost of taxes, maintenance and operation of racing boats in the amount of \$2,155.56 as not being an ordinary and necessary business expense," and asserted the same error in 1950 in disallowing such expense in the amount of \$11,388.43, and in disallowing depreciation on said boats and equipment in 1950 in the sum of \$5,830.84 "as not being assets used in the trade or business of petitioner and not held for production of income" (Tr. 3-4).

In Tax Court Docket No. 57751 Stanley S. Sayres (for whom the executors have been substituted) and wife petitioned the Tax Court (Tr. 13 to 23) for a redetermination of deficiencies in income taxes for the fiscal years ended October 31, 1949, and October 31, 1950, in the respective amounts of \$10,400.69 and \$12,830.51, or a total of \$23,231.20 for both years. In that petition error is asserted in increasing petitioners' "other income for the year ended October 31, 1949, in the sum of \$16,401.51" purportedly received from American Properties, Inc., and in increasing petitioners' "other income for the year ended October 31, 1950, in the sum of \$16,595.31" purportedly received from American Properties, Inc. (Tr. 13-14).

Without going into the mathematical detail, it is

sufficient here to say that what the Commissioner disallowed as expense to American Properties, Inc., he posted as income to Mr. and Mrs. Sayres, sole stockholders of American Properties, Inc.

Other issues, principally salary questions, are raised by the petition of Mr. and Mrs. Sayres in Tax Court Docket No. 57751, and were ruled on adversely to the petitioners and are not raised on this appeal.

The Tax Court made the following Findings of Fact insofar as the same are pertinent to this petition for review (Tr. 27-40):

“The petitioner, Stanley S. Sayres and Madeleine A. Sayres, are husband and wife, and the petitioner American Properties, Inc., is Stanley S. Sayres’ wholly-owned corporation. The individual petitioners reported their income on a fiscal year basis ending October 31. The corporation keeps its books and reports its income on a calendar year basis. The individuals filed separate income tax returns for the taxable year 1948 and filed joint returns for the taxable years 1949 and 1950. These returns and the returns of the corporation for the years 1949 and 1950 were filed with the collector of internal revenue at Tacoma, Washington. The petitioner Stanley S. Sayres is referred to hereinafter as the petitioner, or as Sayres, and the petitioner American Properties, Inc. is sometimes referred to hereinafter by name or as the corporation.

“Prior to 1931 the petitioner was engaged in the automobile business in Pendleton, Oregon. In that year he went to Seattle and purchased Williams Auto Company, a corporation, the name of which he changed to American Properties, Inc. (one of

the petitioners herein). During the years in question he owned all the stock of the corporation except a qualifying share, which was held by his attorney. The petitioner also purchased stock of American Automobile Company. During the years in question he was also the principal stockholder of that corporation. That company operated an automobile dealership and was a tenant of premises owned by American Properties, Inc.

“The petitioner has always enjoyed speed and it had been his desire to drive a boat faster than anyone had ever done before. Prior to going to Seattle he had engaged in outboard motor boat racing.

“After moving to Seattle the petitioner for several years did not engage in boat racing. However, at some time prior to 1948 he purchased a used racing boat which had previously attained a speed of 80 m.p.h., and he named it Slo-Mo-Shun. Thereafter he built successively Slo-Mo-Shun II and Slo-Mo-Shun III. In the design, construction, operation, and maintenance of Slo-Mo-Shun III, the petitioner retained technical assistance of experts who were recognized as outstanding in their fields. Since Ted Jones, the boat designer, was employed on a full-time basis as an engineer with an airplane company, his work for the petitioner was done at nights, on week ends, and on holidays. Anchor Jensen, of the local boat building firm, Jensen Motor Boat Company, was the builder. The petitioner, Jones and Jensen watched the 1948 Gold Cup races in Detroit in August, 1948, and after their experience with the first Slo-Mo-Shun and Slo-Mo-Shun II and III they recognized the tremendous room for improvement in the designing of racing boats. At that time they also recog-

nized the possibility of profit to be made in the designing, construction and sale of racing boats. They considered the possibility that the Navy might become interested in the basic design of these fast boats and might become an important customer. Jones proceeded to design Slo-Mo-Shun IV which would be revolutionary in the field of unlimited hydroplane boats. He used the identical design which he had used for years in building and racing limited class boats. By August, 1949, Jones and the petitioner concluded that Slo-Mo-Shun IV, which was then in the process of construction, would prove to be far superior to boats currently being used.

“The petitioner had consulted his attorney, his accountant, and his financial adviser, an official of the Seattle-First National Bank, who all agreed on the profit possibility in the designing, building, and sale of boats. The banker advised against the petitioner’s undertaking any such business enterprise in an individual capacity. In discussions with the attorney the petitioner suggested that inasmuch as the Articles of Incorporation of American Properties, Inc. already contained provisions which would authorize the construction and sale of boats and marine supplies or engines, such corporation might undertake the venture without the necessity of creating a new corporation.

“The minutes of a meeting of the directors of the corporation held on August 31, 1949, contain the following:

“Preliminary discussions had been had with reference to this corporation entering the field of boat building, ownership and management. Counsel reported that the Articles of Incorporation

were sufficiently broad to warrant entry upon such a program.

“Mr. Sayres in connection with the country-wide interest in power boat racing suggested that ‘Slo-Mo-Shun III, was in his opinion far superior to the major racing boats; that an improvement in design had been perfected and in his opinion ‘Slo-Mo-Shun III’ was by no means the last word in the field. In other words, there would be continuous improvement and if sufficient time was devoted to experimental and engineering work other boats would become obsolete and the Seattle boat would be the pattern all over the country.

“He suggested that he believed if the company would enter the field, do the necessary experimental and engineering work that not only was there money to be made in the manufacture and sale of racing crafts, but in the commercial field as well. That he believed the Government would itself be interested in the fastest type of boat that could be manufactured.

“It was recognized that there would be substantial experimental cost to lay the groundwork for future development.

“He further stated that he was willing to transfer title of Slo-Mo-Shun III to the corporation if the corporation would continue in an endeavor to work out improvements in design and engineering. He particularly suggested that a new improved Slo-Mo-Shun should be designed and built for actual racing use.

“Mr. Sayres also advised that he had substantial offers for Slo-Mo-Shun III and had no doubt of the saleability of Slo-Mo-Shun the IVth and boats of that design and class.

“It was agreed that it was to the best interest of the corporation to enter this new field and proceed with the construction of a new boat upon the improved design of Slo-Mo-Shun III, all with the end in view of when the time was propitious getting into commercial operation.

“Mr. Sayres was authorized to proceed accordingly.

“At this time Slo-Mo-Shun IV was in the process of being built. It was launched in October, 1949.

“At some time before October 31, 1949, the corporation paid to the petitioner an amount of \$14,690.30, which was the amount that had been expended by the petitioner in the construction of Slo-Mo-Shun III and of partial construction of Slo-Mo-Shun IV.

“In 1949 there was no registration or licensing requirements with regard to boats of this character. The petitioner did not enter into any formal document transferring title of either Slo-Mo-Shun III or Slo-Mo-Shun IV to the corporation. There was no patent on the design of these boats.

“The petitioner filled out forms with the county assessor of King County, Washington, for personal property tax purposes, as of January 1, 1950 and 1951, indicating that he was the owner of Slo-Mo-Shun IV. The petitioner left blank the part of such forms calling for information as to whether he had transferred title. He belonged to the Seattle Yacht Club and has always been registered with the American Power Boat Association as the owner of Slo-Mo-Shun IV and V. The rules of that association provided, among other things, that each boat entered for a sanctioned race must be the bona fide property of the person in whose

name she is entered, who must be a racing member of the association and a member of a club belonging to the association; that corporations or business concerns may not enter sanctioned races (although they may be members of the association) and may only enter a boat as the bona fide property of a club member who is also a racing member of the association, either by ownership or by charter.

“On June 26, 1950, Slo-Mo-Shun IV, driven by the petitioner on Lake Washington, established a new world straightaway speed record of 160 m.p.h., breaking the 11-year-old record of 141 m.p.h. Recognizing the capabilities of this boat and the possibility of still further improvements of design in a model to be built, the petitioner sought a contractual arrangement which would include Ted Jones, the designer, and Anchor Jensen, the builder. However, because of disagreement as to technical engineering principles Jones refused to sign an agreement which would include Jensen as a party. On July 17, 1950, an agreement was executed ‘by and between American Properties, Inc. (and/or S. S. Sayres), Party of the First Part, and Ted O. Jones, Party of the Second Part,’ which provided that whereas the first party had financed construction of Slo-Mo-Shun III and Slo-Mo-Shun IV and whereas second party designed both of those boats and assisted in development, construction, and testing, the parties agreed as follows: The second party agreed to work exclusively for the first party in the design and development of ‘Gold Cup’ and ‘Unlimited’ classes of racing boats during the existence of the contract and a period of one year thereafter; second party agreed not to disclose to others any basis or essential features of design, construction, or develop-

ment; first party agreed that when constructing racing boats only second party would be employed to design such boats and to supervise construction, and that upon all boats sold by first party, in whom title should always rest, second party would receive a fee of \$5,000 or 10 per cent of sale price, whichever was greater, this being in addition to time and material charges such as had been paid in the past; first party agreed that if Slo-Mo-Shun IV should be sold for an amount greater than cost, first party would pay second party 10 per cent of actual net profit after taxes, or a flat sum of \$5,000, whichever was greater, in which case second party would, in consideration thereof, design a new 'Unlimited' class racing boat for first party at no additional fee; both parties agreed that in event of any sale of plans and designs of 'Gold Cup' and 'Unlimited' boats, first party would pay second party a fee of \$2,500 together with traveling expenses and a fee of \$25 per day actually spent in supervising construction. It was provided that the agreement should continue until terminated by written notice of either party, giving 180 days' notice. It was signed by S. S. Sayres as president of American Properties, Inc., and in his individual capacity, and by Jones.

"On July 22, 1950, Slo-Mo-Shun IV, driven by Ted Jones, won the Gold Cup race. Following that Jones was approached by others seeking boats of the design of Slo-Mo-Shun IV. Horace Dodge sought to have two boats built, offering \$50,000 per boat. Jones sought approval of the petitioner which was refused.

"Slo-Mo-Shun IV, driven by Lou Fageol, won the Harmsworth Trophy on August 2, 1950.

"In August, 1950, the Seattle-First National

Bank loaned American Properties, Inc., \$26,000 to be used in operations in connection with the boats. No collateral was given for the loan.

“In February, 1951, construction of Slo-Mo-Shun V was commenced for the purpose of entering the 1951 Gold Cup races. The petitioner prevailed upon Jones and Jensen to work together in the construction of the boat. The boat was constructed at the premises of the Jensen Motor Boat Company under the supervision of Jones and with the aid of some of Jensen’s boat builders. The boat was completed by the end of July, 1951. Jones received \$5,000 for designing Slo-Mo-Shun V in addition to compensation received on an hourly basis for its construction.

“Lou Fageol, a wealthy sportsman who was one of the top two or three drivers in the country, drove Slo-Mo-Shun V and won the Gold Cup in 1951.

“In 1952 Slo-Mo-Shun IV, driven by Stanley Dollar, a wealthy man of the Stanley Dollar Steamship Lines, won the Gold Cup race. Joe Taggart, who has had as much racing experience as Fageol, also drove the Slo-Mo-Shun boats in competition. In 1953 and 1954 either Slo-Mo-Shun IV or Slo-Mo-Shun V won the Gold Cup races. The Slo-Mo-Shun boats have also won the Martini-Rossi Trophy for the fastest heat in a Gold Cup race and the Aaron DeRoy Plaque for the fastest over-all average. The petitioner’s name appears on the Gold Cup as the winner and the various trophies which were won by Slo-Mo-Shun boats were kept at the Seattle Yacht Club. There were no cash prizes in racing these boats.

“The petitioner did not himself personally drive

any of the boats in closed course competitive races, such as the Gold Cup or the Harmsworth races. He did drive in speed competition, as in 1950 when he broke the world's straightaway speed record.

“About November 1, 1951, Ted Jones left Seattle and went east to work as a boat designer for another concern. He thus ceased to operate under the agreement of 1950. No formal notice of termination of the contract was ever given by either party. Because he felt restrained by the contract of 1950, Jones did not, for a number of years, build any boats for others of the design of the Slo-Mo-Shun boats, although he had many opportunities to do so. However, commencing in January, 1954, he did design a number of boats for various individuals throughout the country, employing the design of the Slo-Mo-Shun boats. At the time of the hearing in this case in 1956, there were about 20 boats eligible for competition in the unlimited class, of which all but four were of the basic Slo-Mo-Shun design.

“The members of the crew of these boats included highly skilled technicians who worked on the various Slo-Mo-Shun boats in their spare time since they were full-time employees of other organizations. None of them was employed by either American Properties, Inc. or American Automobile Company. Jones was compensated for designing the boats and Jensen was paid for his work in building them.

“The principal construction work took place at the Jensen Motor Boat Company, but the engine work was done at the premises of American Properties, Inc., then under lease to American Automobile Company, where there was a machine shop for assembling engines. The small hand tools

which were used were the property of American Properties, Inc. Only occasionally was equipment of American Automobile Company used. An electric hoist which was used was not the property of American Automobile Company. Engines and parts were stored at these premises.

“All costs of completing and operating Slo-Mo-Shun IV and the cost of building and operating Slo-Mo-Shun V were borne by the corporation, including the expenses incurred in racing them, such as traveling expenses of the crew to Detroit in 1950.

“The building owned by the American Properties, Inc. was located about one and one-half to two miles from the nearest navigable body of water. Slo-Mo-Shun III was moored at a dock at the petitioner's residence on Lake Washington to which he moved in December, 1950, and the Slo-Mo-Shun boats were then housed in the boat house at such residence. At times the boats were housed at the Jensen Motor Boat Company, which is on Lake Washington about five miles from the petitioner's new residence.

“Greater Seattle, Inc., a nonprofit, publicly subscribed corporation which promoted the annual Seafair and other sporting events, sponsored campaigns to raise money for the operation of the Slo-Mo-Shun boats because of the advantage to Seattle of bringing the Gold Cup race to Seattle. In 1950 the amount contributed by Greater Seattle, Inc. for this purpose was \$6,912.15. This contribution, whether paid to the petitioner in the first instance, or to the corporation, was ultimately received by the corporation to defray part of the expense of operating Slo-Mo-Shun IV. In subsequent years other contributions were also received from

Greater Seattle, Inc. through campaigns for public subscription. In sponsoring campaigns for raising money for this purpose, Greater Seattle, Inc. held the petitioner out as the owner of the boats. Newspaper articles also consistently referred to the petitioner as the owner of the boats. The official programs of the Gold Cup races listed him as the owner.

“The petitioner has never sold any of the Slo-Mo-Shun boats or any designs therefor. After Slo-Mo-Shun IV had been constructed some civilian representatives of the Navy Department examined it and observed it in action. There was no subsequent indication that the Navy would be interested.

“In its income tax returns for the calendar years 1949 and 1950 the corporation shows its principal business activity as ‘Real Estate’ and ‘Lessor of Building,’ respectively. It reported net income of \$8,423.26 in 1949 and a net loss of \$1,561.41 in 1950. Its returns show that it had surplus at December 31, 1949, of \$74,659.49 (of which \$37,497.43 was earned surplus) and at December 31, 1950, surplus of \$71,260.73 (of which \$34,098.67 was earned surplus).

“In the calendar year 1949 the corporation expended \$2,155.56 in operation and maintenance of the boats, which it deducted on its corporate tax return as business expenses. The respondent disallowed this amount to the corporation. In addition, the corporation expended \$561.39 as additional boat expense which it did not deduct on the corporate return.

“For the calendar year 1950 the corporation expended \$19,300.58 for operation and maintenance of the boats and deducted on its return the amount of \$12,388.43 (after offsetting the contribution

from Greater Seattle, Inc., in the amount of \$6,-912.15). In the return there was included \$1,000 as income from endorsement of an oil product. In this situation the respondent considered that there had been claimed a net deduction of \$11,388.43, which he disallowed.

“The corporation capitalized on its books and its returns for 1949 and 1950 the amounts expended for construction of the boats and related equipment (including the amount of \$14,690.30 which was paid by the corporation to the petitioner as hereinabove stated). In the 1949 return the balance sheet at the end of the year includes in depreciable capital assets the amount of \$18,609.16 for boats and equipment, but no depreciation was claimed. For 1950 the amount of capitalization of boats and equipment at year end was \$22,323.37 upon which depreciation was allowed in the amount of \$5,-830.84, which was disallowed by the respondent. The respondent included as additional income of the individual petitions all amounts expended by the corporation in connection with the boats. Inasmuch as the individuals were on a fiscal year ending October 31, whereas the corporation was on a calendar year basis, the respondent determined the amounts which had been expended during the taxable year of the individuals. For the fiscal year ended October 31, 1949, the respondent attributed additional income to the individuals in the amount of \$16,401.51, consisting of \$1,149.82 of disallowed corporate expenses to October 31, 1948; \$561.39 representing additional boat expense paid by the corporation and not deducted on the corporate return, and \$14,690.30 representing the amount paid to the petitioner by the corporation and capitalized on the corporate return. For the fiscal year

ended October 31, 1950, the respondent attributed additional income to the individuals in the amount of \$16,595.31, consisting of \$1,005.74 expended by the corporation as boat expenses from November 1, 1949, to December 31, 1949; \$7,956.50 of net expenses from January 1, 1950, to October 31, 1950, and \$7,633.07 expended during the year ended October 31, 1950, and capitalized by the corporation.

“On June 29, 1951, the corporation filed a claim for refund of taxes for the year 1949, based upon the carry-back of a claimed net operating loss for 1950. On August 19, 1952, the corporation filed another claim for refund for the year 1949, based upon a claim that it understated its net operating expenses by the amount of \$561.39 referred to hereinabove.” (Tr. 27-40)

It should be noted that in addition to the facts found by the court the following facts were adduced at the trial: That as early as July 17, 1950 (three weeks after Slo-Mo-Shun IV had set the world's record and five days before the 1950 Gold Cup race) the rift between Jones as designer and Jensen as builder had already progressed to the point where Jones refused to sign the original draft of Exhibit 1 because Jensen was also a party to it (Tr. 94-95, 211-212).

The disagreement between Jones and Jensen progressed to the point that in the fall of 1951 Jones left American Properties, Inc. to go with the manufacturer of Mercury outboard motors (Tr. 99-100). His engaging in the production and sale of racing boats for profit is his sole livelihood (Tr. 99-100, 202, 204-205, 209-212).

Sayres testified that the “prime thing” or “primary

motive or purpose" in going into the construction of the boats was the business opportunity (Tr. 101-103).

The late Tracy E. Griffin, attorney for Sayres and all of his business interests since Sayres' arrival in Seattle in 1931, a past president of the Washington State Bar Association, Seattle Bar Association, and delegate to the American Bar House of Delegates (Tr. 162-163), testified that the resolution of the Board of American Properties, Inc., Exhibit 4, represents a bona fide meeting of the board on or about August 31, 1949 (Tr. 162-164). He further testified:

"Mr. Sayres very definitely entered into this venture with the idea of not only having it pay its own way, but of being a profitable enterprise. I heard his testimony in regard to the Navy situation, I confirm that conversation with him. It was days back there (*sic*) where he was very optimistic and the optimism continued in—

Q (interrupting) Optimistic in reference to what?

A. In being able to have a new profitable venture in the building and construction of these boats, the sale of boats, the sale of rights to the boats, perhaps certain marine equipment as time went on." (Tr. 164)

Albert R. Munger, retired president of the Seattle-First National Bank, testified in reference to Sayres consulting him about the profit possibilities of these boats:

"A. Well, so far as the business aspect of going into the manufacture and sale of boats was concerned, his question of me was my opinion on the desirability of entering into that venture as a business enterprise.

Q. And specifically doing what in a business way with the boats?

A. To make an arrangement with Ted Jones and Anchor Jensen whereby the three together would be interested in the building and the sale of boats of the type that Mr. Jones had designed.

Q. What ultimately evolved in that discussion?

A. Well, my advice to Mr. Sayres was favorable to the venture — I advised him that in my opinion it was sound and promising business venture.

Q. And did you make any recommendation to him as to any corporate organization?

A. I cannot distinctly remember making any recommendation on my part, but I was a party to the discussions that involved in what ownership and in what form that business should be conducted. I had only one stipulation in respect to the base interest (*sic*) that he should not enter it individually.

Q. I see. I take it from that he should either organize or select a corporation?

A. That was the effect of it.

Q. Did you ever hear the subject of the Navy mentioned or discussed in any of those conversations?

A. Oh, yes.

Q. In what regard?

A. Well, it was one of the factors that was of importance in making up one's mind as to the desirability of the business venture, and the circumstances were that we all had in mind the experience with the PT boats during the war with the thought that they had been extremely valuable to the Navy and that it might very well be that

the Navy would become a very important customer for this business venture in the development and purchase of the successor models of the PT boats for use in rescue and in all other affairs where speed was the prime requisite because in my opinion it was evident that a boat designed along these lines would be far speedier and more useful to the Navy than the PT boats had been in the recently ended war.

Q. Other than the Navy and/or Coast Guard or other government user of high speed boats, what other prospective purchaser or purchasers was it anticipated would buy this type of high speed vessel?

A. Well, in my thinking there were probably a large number of prospective purchasers for these reasons, first, it was evident in our minds at least, that Ted had designs here that would just revolutionize the capacity and the construction of these unlimited hydroplanes, in the second place, he was able to build them for what seemed to me a rather modest cost, in the third place, that those people interested in owning and operating racing boats of this type had been accustomed to spending much larger sums for their boats, and that they would readily pay prices for these new developments that might run to two or three times the actual cost of producing the boats. In other words, it could be very profitable.

Q. Did you, when I say you, I mean your bank, the Seattle-First National Bank, have any occasion to invest by loan or otherwise in this venture?

A. Mr. Sayres borrowed for the American Properties, Inc., a sum of money that I think was between twenty-five and thirty thousand dollars,

some time after our conversations, and I think probably in the year 1950.

Q. Did you approve that loan or at that time were you on the loan committee, do you recall?

A. I was chairman of the loan committee, but I was not an active loan officer, that loan was made by a loan officer in one of our branches. It came before me for approval in the normal run of the bank's business.

Q. The borrower on that loan was who?

A. American Properties, Incorporated." (Tr. 170-172)

Ted Jones, called as a witness by the respondent, testified that, after designing Slo-Mo-Shun IV and V, he designed the Breathless for J. Murphy; Miss Thriftway for Associated Grocers; the Rebel Suh, Gail VI for Joe Schoenith; a boat for Henry J. Kaiser; the Wahoo for Bill Boeing, Jr.; the Shanty for W. T. Waggoner; a spare hull each for Boeing and Waggoner; and redesigned the Gails, Such Crust (owned by Jack Shafer), Tempo (Guy Lombardo) and Super-test (Tr. 202-204). Under direct examination by respondent's counsel, he testified that these boats are exceptionally seaworthy and built for rough water usage and would be usable as a PT boat if the length of the hulls was stretched out to 50 feet (Tr. 208-209). He further testified on cross-examination:

"Q. Now, Mr. Jones, I take it that when you and Mr. Sayres signed this agreement, Exhibit 1, you were anticipating what would happen in the event of a sale of either of the boats of the design or of the class that you had designed, or of the plans for those boats, were you not?

A. Yes.

Q. That is the arrangement provided for for you in that agreement?

A. That is right.

Q. Did you and he anticipate that that might be a likelihood, that is to say, that the design may be in demand for boats produced—

A. (Interrupting) My entire life has been devoted to come up with something fast in the water, and I was very sure that when it was proven that it would finally pay off.

Q. And be profitable?

A. Right.

Q. And you ultimately have made that your career, have you not?

A. That is right.

Q. And these boats that you have referred to as being designed by you for various people throughout the country are on this principle of the IV and V, are they not?

A. Yes, they are.

Q. And at the time that that design was perfected in IV and V, it was a revolutionary design in reference to the construction of unlimited hydroplanes which preceded it, is that right?

A. As far as the unlimited, yes, but it was identical to my limited boats that I had been racing for a good many years.

Q. You were interested and prompted, I take it, by, and are now, are you not, by profit incentive as well as a natural interest in the subject, are you not?

A. Yes.

Q. Do you now make your living or is your income now solely derived from this pursuit?

A. It is." (Tr. 209-210).

QUESTIONS INVOLVED

(a) Did Petitioner, American Properties, Inc., enter into and carry on a racing boat venture with a profit motive in the calendar years 1949 and 1950, thereby incurring ordinary and necessary expense in the maintenance, operation and depreciation of said boat?

(b) If the answer to (a), *supra*, is “No,” then were the amounts so expended by said corporation taxable income to the sole stockholders, Stanley S. Sayres and Madeleine A. Sayres?

(c) If the answer to (b), *supra*, is “Yes,” then was the racing boat venture entered into by Mr. and Mrs. Sayres with a profit motive, rendering the expense of maintenance, operation and depreciation deductible?

Needless to say, the Tax Court by decision dated February 14, 1958, (Tr. 60) decided that the expense of the boats was not deductible to American Properties, Inc., and such expense was taxable income to Mr. and Mrs. Sayres.

SPECIFICATION OF ERRORS

1. The finding of the Tax Court that “during the years in question the activities of the petitioner and the corporation with respect to the boats were not conducted with the intention of making a profit and that such activities did not constitute the conduct of a trade or business by either the petitioner or the corporation” (Tr. 51), is clearly erroneous.

2. The finding of the Tax Court that American properties, Inc., was “not entitled to deduct the cost of maintenance and operation of the boats under section 23 (a)

(1) of the Internal Revenue Code of 1939, as ordinary and necessary expenses paid or incurred in carrying on a trade or business and that it is not entitled to deductions for depreciation on the boats, irrespective of whether title to the boats was in the corporation, since section 23 (1) requires, as a condition to such depreciation deductions, that the property be used in a trade or business" (Tr. 51-52), is clearly erroneous.

3. The finding of the Tax Court that "the respondent's determination that the amounts in question are taxable to the individual petitioners is approved" (Tr. 53), is clearly erroneous.

4. The finding of the Tax Court that "neither the corporation nor the individual petitioners was engaged in the business" and that the expenditures in connection with the boats may not be deducted by the individual petitioners (Tr. 53) is clearly erroneous.

5. The finding of the Tax Court that "We believe that the parties had in mind merely the possibility of entering into a commercial venture at some future time when it might be deemed expedient to do so" (Tr. 47) is clearly erroneous.

6. The Tax Court erred in entering its decisions in these consolidated cases that there were deficiencies in income tax for the taxable years 1949 and 1950 as to American Properties, Inc., and in the fiscal years October 31, 1949, and October 31, 1950, as to the individual petitioners (Tr. 59-60). It should be here noted that error is only assigned to that portion of the decision involving the question of the deductibility of the boats to American Properties, Inc., and the concomitant in-

crease in income to the individual petitioners. It should be further noted that no error is assigned by reason of the court's decision of salary questions or the assessments of negligence penalties occasioned by salary questions.

The reason why petitioners on review point out the fact that they do not assign the salary and penalty questions as error is that in clear violation of the last sentence of this Court's Rule 17 (6), the respondent has caused the entire transcript of the testimony to be printed by its cross-designation when, as is apparent, a large portion of that transcript of testimony (Tr. 40-43, 53-58, 185-201, 218-219, 228-234) pertains only to salary and penalty issues. It is further noted that respondent did not designate for printing the petitions in Tax Court docket Nos. 57749 and 57750, which raised the salary and penalty questions. Petitioners here invoke Rule 17 (6) as to the printing of those portions of the transcript of the testimony on which no issue is joined in this court.

ARGUMENT

Counsel for the respondent aptly stated in the trial court the issue: "Your Honor, this whole case rests on the business motive versus the hobby motive" (Tr. 145).

It is interesting to note that Sayres went into the automobile business through the American Automobile Company (now Stan Sayres, Inc.) as a result of his interest in driving automobiles at high rates of speed. No one contends or could contend that the corporate

income of that business was the personal income of Sayres because speed was his hobby.

The Venture Was Entered Into With a Profit Motive

A full reading of the court's opinion (Tr. 25-40, 44-53) discloses that despite the court's opinion and conclusion that the boat venture was gone into with a bona fide profit motive that the court arrived at its decision by the further conclusion that the business venture never materialized. This, we submit is in error.

As will be demonstrated by authorities hereinafter cited, it is clearly not the law that enjoyment of one's business enterprise converts it from a business to a hobby. It is apparent that the theory of Sayres was, when he and Jones and Jensen became convinced that they had the fastest boat in the world abuilding, that it could be profitable only by breaking the world's record and proving itself in competition, thereby focusing the attention of the racing world (and any other interested persons) on the prototype, Slo-Mo-Shun IV.

The future proved Sayres' predictions to be correct, *i.e.*, the Slo-Mo-Shun IV conclusively smashed the world's record on June 26, 1950, and a few weeks later the boat invaded Detroit and conclusively won the Gold Cup Race.

It is not without significance that Jones left American Properties, Inc., in 1951 and went on with the venture on his own account, makes a handsome profit at it and engages in it as his sole and exclusive means of livelihood. His dominance in the field is exemplified by the fact that of the 20-odd unlimited class hydroplanes

in existence, he has designed all but approximately four. To conclude that this venture is not one capable of profit is unwarranted.

The fact that Sayres did in fact go into the venture through American Properties, Inc., with a bona fide profit motive cannot in honesty be disputed under the unequivocal testimony not only of Sayres (who was well enough respected in his own community of over half a million people to be named as its "Man of the Year") (Tr. 125-126), but of his counsel, his accountant and his financial advisor, when such testimony was neither challenged nor capable of challenge.

The only apparent challenge made by the respondent was the quibbling over the record title to the vessel when the evidence showed there was no record title (Tr. 95-96) because the transfer was made at a time when the boat was not even completed. It appears to be the respondent's position that the title was in Sayres because the public thought so, and that it is a plaything of a wealthy sportsman because he is wealthy and enjoys "test-hopping" of the boat (Tr. 100-103).

There can be no doubt as to the applicable law. More than twenty years ago the proper test was announced:

"The proper test is not the reasonableness of the taxpayer's belief that a profit will be realized, but whether it is entered into and carried on in good faith and for the purpose of making a profit, or in the belief that a profit can be realized thereon, and that it is not conducted merely for pleasure, exhibition, or social diversion. . . ." *Doggett v. Burnett* (1933) 65 F.2d 191.

"The intention of the taxpayer at the outset is

the dominant factor in determining whether he engaged in the venture merely for pleasure or for profit." *W. S. Farish v. Commissioner* (1939) 103 F.2d63; *S. P. Farish v. Commissioner* (1939) 103 F.2d 65. See also *Commissioner v. Field*, 67 F.2d 876; *Doggett v. Burnett, supra*; *Thacher v. Lowe*, 288 Fed. 994; *Edwin S. George*, 22 BTA 189.

The respondent's case consisted of a showing that Sayres referred to it as his boat, signed assessor's tax returns (Exs. I and J) and the boat was entered in Sayres' name in competition.

There was, of course, no documentary evidence of title (Tr. 95-96). It is at once apparent from an examination of the assessor's return that its purpose is to arrive at a *value*, not the ownership of the boat. The assessor in sending the return to Sayres for signature doubtless assumed, as apparently the newspapers and public did, that Sayres was the owner. Sayres could see no purpose (and neither do we) in indulging in detailed explanations to the public that they were in error in referring to him as the owner, since there is no interest in the subject (Tr. 148-149).

The Tax Court held that in any event the question of whether title passed from Sayres to the corporation was not itself decisive of the issues presented (Tr. 45).

As to the entry of the boat in competition as Sayres', it is clear that this was required by the rules of the American Power Boat Association (Tr. 149-157, Ex. 5). In this connection it will be noted that Miss Thriftway, owned by Associated Grocers (who operate the "Thriftway" Stores) is entered in competition as being

owned by Willard Rhodes (Tr. 148-157, 203-204, Ex. U, p. 17), an executive of the company actually owning it, and that such was the practice with other racing boats owned by commercial firms.

That petitioner's incentive was profit has been clearly pointed out by previous references to the record.

Section 23 of the Internal Revenue Code of 1939, to which the Tax Court referred in its opinion, states:

“In computing net income there shall be allowed as deductions:

“(a) Expenses.

“(1) Trade or business expenses.

“(A) In General. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . .

“(e) Losses by Individuals. In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

“(1) if incurred in trade or business; or

“(2) if incurred in any transaction entered into for profit, though not connected with the trade or business. . . .”

While it is true the operation was not profitable for the years in question, the fact of recurrent losses is not sufficient ground for denial of the relief asked.

“That the petitioner did not claim a deduction for losses prior to 1927 and that the stable was unprofitable for the eight years it had existed will not support the decision (against the taxpayers) of the Board under the evidence in the case.” *Whitney v. Commissioner* (1934) 74 F.2d 589.

“The whole question here is to determine wheth-

er, as a matter of fact, the intention of petitioner has been to realize a profit from the operation of this farm, and this question may not be determined solely from the recurrence of losses.” *Israel O. Blake v. Commissioner* (1938) 38 BTA 1457. See also *Lillie S. Wegeforth v. Commissioner* (1940) 42 BTA 633; *Commissioner v. Field* (1933) 67 F. 2d 876).

Petitioners should not be denied deductions simply because they derived pleasure and fame from their business and were able to absorb losses.

“The fact that petitioners were wealthy enough to afford a hazardous occupation in which they found pleasure despite discouraging losses does not establish the essential nature of the occupation. If they were utterly indifferent to whether there was loss or gain, or if it were shown the stables were an incident to the social or domestic aspects of their daily lives, the result might be against them as in *Thacher v. Lowe* (D.C.) 288 Fed. 994, 2 AFTR 1931. Instead it appears they devoted themselves seriously and assiduously to the economic promotion of their stables, always in the hope that profit would result. The winning of a single race or the chance purchase of a yearling might at any time convert steady losses into a net profit, and make it a successful business.” *Commissioner v. Widener* (1929) 33 F.2d 833.

As was said in *Black Dome Corp.*, 5 TCM 455, §46, 130 P-H Memo TC 1946).

“It is clear that throughout this period petitioner’s activities were directed towards the realization of profit from the operation of petitioner’s property and not for the pleasure and recreation of petitioner’s sole stockholder.” (Citing *Marshall-*

Field, 26 BTA 116, aff'd 67 F.2d 876). "The fact that petitioner's property had not been operated at a profit for many years does not require a different conclusion."

The profit and loss or other financial statement of a venture does not purport to classify it as being a business or a hobby.

"An occupation or employment will not be excluded from the classification of business merely because it actually results in loss instead of profit; but it is essential that livelihood or profit be at least one of the purposes for which the employment is pursued." *Deering v. Blair* (1938) 23 F.2d 975, 976.

Here, as in the *Whitney* case, *supra*, there is "no substantial evidence to support the conclusion that the pleasure of owning (the business) was the primary interest of the petitioner in operating it."

"If it can be shown the subsidiary enterprise was operated with the motive of eventual profit, the expenses thereof and any losses are deductible even though the enterprise is of a kind usually considered a hobby or recreation." *NYU Ninth Annual Institute on Federal Taxation* (1951), page 337 *et seq.*

and:

"... that purpose (pecuniary gain) need not be exclusive. It is sufficient if the profit aim is the prime thing. . . ." *George F. Tyler* (1947) 6 TCM 275, §47,058 P-H Memo TC.

The allowance of losses has not been predicated upon the particular type of occupation. Losses have been held deductible in:

G. F. Tyler, supra, stamp collector;

J. L. Byrne, 4 TCM 1096, §45,371 P-H Memo TC 1945, dog kennel;

Doggett v. Burnett (1933) 65 F.2d 191, religious publications;

Amos J. Bumgardner, infra, dog kennel operated by dentist;

Blake v. Commissioner (1938) 38 BTA 1457, horse stable;

Black Dome Corp., supra, operation of estate grounds, lake, etc.

Neither can the losses be denied on grounds petitioners have other principal sources of income.

“Deduction of a loss is not to be denied by reason of the fact that the taxpayer has one or more other enterprises from which he receives his principal source of livelihood.” *NYU Ninth Annual Institute on Federal Taxation* (1951) page 337, *et seq.*; *Marshall Field* (1936) 26 BTA 116, *aff'd* 67 F.2d 876; *Moses Taylor* (1927) 7 BTA 59.

As noted, the determination of the taxpayer's intention is most important. A recent case, *Amos J. Bumgardner*, 13 TCM 128, §54, 047 P-H Memo TC, 1954, has set forth indicia of such intention, as follows:

- (1) A thorough preliminary exploration of the field and the possibilities of profit. *Irving C. Ackerman* (1931) 24 BTA 512, *aff'd* 71 F.2d 586.
- (2) The consultation of experts and the hiring of qualified help or assistants. *Margaret E. Amory* (1931) 22 BTA 1938.
- (3) Considerable personal attention to the enterprise. *Laura M. Curtis* (1933) 28 BTA 631.

- (4) And a businesslike method of accounting for income and expenses and concern for the economics of the operation. *Wilson v. Eisner* (1922) 282 Fed. 38.

A brief summary of the evidence clearly shows petitioners' intention to engage in a profitable business. They made a thorough examination of the field, built and tested prior boats, made a trip to the 1948 Gold Cup in order to appraise, examine and analyze the then fastest boats; and Sayres deliberated the possibilities of profit with his attorney, accountant and financial advisor. For design he consulted with and hired Ted Jones, the foremost authority in the nation; as builder there was Anchor Jensen, a Northwest boat builder of high repute; for mechanics and crewmen there were, among others, Mike Welsh, a highly-skilled technician in electronics, Elmer Leninschmidt from Western Gear Works. The drivers of the Slo-Mo-Shun were the best in the business, Joe Taggart, Lou Fageol, and Stan Dollar. That the enterprise was time-consuming and demanded the personal attention of Sayres is clearly shown. There were stockholders' meetings, consultation with attorneys, accountants, bankers, discussions with Jones, Jensen and crewmen, trips to Detroit, testing of boats, experimentation of gear, motors and equipment, etc. Further, books of account were properly kept and concern for the economics of the operation is evidenced by requests for advice from competent persons. Bank loans were made in a normal businesslike manner. In short, Mr. Sayres did all, even more than could be expected of a prudent businessman.

In this connection it is to be noted that the Tax Court

found as a fact (referring to Sayres, Jones and Jensen) that

“They recognized the tremendous room for improvement in the designing of racing boats. At that time they also recognized the possibility of profit to be made in the designing, construction and sale of racing boats. They considered the possibility that the Navy might become interested in the basic design of these fast boats and might become an important customer. . . .

“The petitioner had consulted his attorney, his accountant and his financial advisor, an officer of the Seattle-First National Bank, who all agreed on the profit possibility in the designing, building and sale of boats.” (Tr. 28-29)

**The Tax Court Misconstrued the Language of the
Resolution of American Properties, Inc. of
August 31, 1949 (Ex. 4)**

It is apparent from a reading of the opinion of the Tax Court that the Court arrived at its conclusions partially from a misconstruction of the meaning of Exhibit 4, Minutes of the Meeting of Directors of American Properties, Inc., held August 31, 1949. Those minutes are set out in full in the Findings, *supra* (Tr. 30-31), and in part stated:

“It was agreed that it was to the best interest of the corporation to enter this new field and proceed with the construction of a new boat upon the improved design of Slo-Mo-Shun III all with the end in view of when the time was propitious getting into commercial operation.” (Exhibit 4, Tr. 31)

The Tax Court concluded (Tr. 48): “This left the

intended time of actually entering into business in an uncertain state.” This is the basis for the Court’s finding that “the parties had in mind merely *the possibility* of entering into a commercial venture at some future time when it might be deemed expedient to do so” (Tr. 47). What is apparent is that what was left for the future was “getting into commercial operation,” not getting into business.

Furthermore, Sayres testified:

“Q. By the way, to the extent that there may be confusion about it, this Exhibit 4, being the resolution of American Properties of August 31, 1949, is that the date upon which your conception of this being a profitable venture actually materialized?

A. That is the date on which we said, ‘Here we go.’ ” (Tr. 97-98)

It is abundantly clear from the record that American Properties, Inc., in a bona fide honest, businesslike manner determined to and did enter into a venture with a profit motive and did forthwith as the resolution and the facts indicate “proceed with the construction of a new boat upon the improved design.” The resolution showed that the company believed that it had to do “the necessary experimental and engineering work” and “it was recognized that there would be substantial experimental cost to lay the groundwork for future development” and that the corporation was to “continue in an endeavor to work out improvements in design and engineering. He (Sayres) particularly suggested that a new, improved Slo-Mo-Shun should be designed and built for actual racing use” (Ex. 4, Tr. 30-31).

It seems clear to us that this manifested a *present*

intention to commence on a business basis and with a profit motive the construction of unlimited hydroplanes. Within 60 days the corporation had carried out the intention and had physically completed Slo-Mo-Shun IV which fulfilled every prophecy made for her while she was on the drawing boards.

What is apparent is that the lower Court has construed the resolution and the conduct of the taxpayers as meaning that some time in the future they might evolve a business purpose from this project. This is patently not true. The purpose which the directors had in mind and which they clearly articulated in plain and concise language was that the actual sale of boats would necessarily have to follow the performance of the pilot model then on the drawing boards and that if that vessel made a record for itself, they would then be able to get into "commercial operation," which we deem to mean marketing boats, designs, and the like. To conclude, as the Tax Court did, that this resolution merely manifested a future intent to embark on a commercial venture is simply not supported by the language used, the conduct of the petitioners, nor by any portion of the record.

We think it further unwarranted to conclude from this resolution, from the absence of a record title, and from the rejection by Sayres of one isolated offer to build for Horace Dodge that ergo, the construction, maintenance and operation of the boat was Sayres' personal hobby.

The Boat Was Not a Personal Hobby

The unchallenged fact (which, indeed, the trial court

found to be a fact (Tr. 35)) that Sayres never drove the boat except on the occasion that it broke the world's straightaway record and occasionally in testing new equipment, seems to us to be inconsistent with the court's conclusion that the boat was the personal hobby of Sayres. It should be apparent that these boats are designed and used as racing boats and that Sayres never drove them except on the occasions mentioned.

It should be further noted that there is no prize money in racing the boats and the court so found (Tr. 35). Any analogy to owning race horses is clearly inapplicable.

The boats can certainly not be classified as a pleasure craft (Tr. 89):

“Q. Is it fair to state, then, that your desire or enthusiasm for speed is not satisfied by driving the Slo-Mo-Shun IV or V in racing competition, you do not satisfy it in that manner?

A. No, I would like to, but there are some good reasons not to.

Q. And you haven't?

A. I have not.

Q. Other than the original breaking of the world record in June 23, 1950, have you driven these boats or either of them competitively?

A. No.” (Tr. 88-89).

The Tax Court concluded that petitioner's refusal to accept one isolated offer to purchase boats “is certainly not consistent with the claim that he was interested in profit. On the contrary it indicates a continuation of the hobby for his personal pleasure and satisfaction”

(Tr. 49-50). If such were the fact, the conclusion would still be not valid, but the fact is that no one ever made any direct offer to Sayres to purchase boats (Tr. 141-142). In fact, the trial judge summarized his testimony as follows:

“As I understand it, the witness has said that he had had some indirect offers and if it had been a big enough price, he would have sold. And he says that he did say at this time that he would not sell, however, unless he had another boat to defend in the races.

THE WITNESS (Sayres): ‘Yes, sir, that is correct.’ ” (Tr. 145).

Sayres further testified:

“ . . . had I sold it in 1950 that would have probably ended any hopes I had of going on with the development, continuing development and getting into the boat business. It could have. That is a question that nobody can answer flatly.” (Tr. 142).

It should also be borne in mind that Slo-Mo-Shun IV was not built and improved for the purpose of selling that particular boat. It was built as a pilot model of a new design (Tr. 147). The company would have had to start another boat to continue the development of design and equipment.

We submit that the overwhelming weight of the evidence clearly demonstrates that:

1. American Properties, Inc., engaged in the racing boat venture as a trade or business with a profit motive and that the ordinary and necessary expense incurred in that venture was deductible pursuant Section 23 (a) (1) of the Internal Revenue Code of 1939.

2. The expense would be in any event deductible to the individuals as a "transaction entered into for profit, though not connected with the trade or business," under Section 23 (e) of the Internal Revenue Code of 1939.

We respectfully submit that the decision of the Tax Court be reversed.

Respectfully submitted,

KENNETH P. SHORT

Counsel for Petitioners

1107 American Building,
Seattle 4, Washington.

APPENDIX

In conformity with Rule 18, subdivision 2 (f), the following is a list of the exhibits which were identified and received or rejected at the following pages of the Transcript of the Record:

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2	91	92
3	92	92
4	93	93
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G	103	103
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J	105	106
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M	111	116
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Rejected

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T	136		140
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In the United States Court of Appeals
for the Ninth Circuit

AMERICAN PROPERTIES, INC., and the ESTATE OF
STANLEY S. SAYRES, DECEASED, HAROLD L. SCOTT,
and A. R. MUNGER, EXECUTORS, and MADELEINE
A. SAYRES, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decisions of the
Tax Court of the United States

BRIEF FOR THE RESPONDENT

CHARLES K. RICE,
Assistant Attorney General.

LEE A. JACKSON,
I. HENRY KUTZ,
C. GUY TADLOCK,
Attorneys,
Department of Justice,
Washington 25, D. C.

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**In the United States Court of Appeals
for the Ninth Circuit**

No. 16051

AMERICAN PROPERTIES, INC., and the ESTATE OF
STANLEY S. SAYRES, DECEASED, HAROLD L. SCOTT,
and A. R. MUNGER, EXECUTORS, and MADELEINE
A. SAYRES, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

**On Petition for Review of the Decisions of the
Tax Court of the United States**

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Tax Court (R. 25-58) is reported at 28 T. C. 1100.

JURISDICTION

This petition for review (R. 61-63) involves additional federal income taxes determined against American Properties, Inc., for the taxable years 1949 and 1950 in the respective amounts of \$495.78 and

\$3,601.31; and against Madeleine A. Sayres and Harold L. Scott and A. R. Munger, Executors of the Estate of Stanley S. Sayres, deceased,¹ for the taxable year ending October 31, 1949, in the amount of \$10,400.69, and income taxes and penalties for the taxable year ending October 31, 1950, in the respective amounts of \$12,830.51 and \$641.53. (R. 8-9, 18.)² On February 17, 1955, the Commissioner of Internal Revenue mailed to the taxpayers notices of deficiencies covering the above amounts. (R. 6, 16.) Within 90 days thereafter and on May 11, 1955, the taxpayers filed petitions with the Tax Court for a redetermination of the deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939, as amended. (R. 10, 23.) The decisions of the Tax Court were entered on February 14, 1958. (R. 59, 60.) The cases are brought to this Court by a petition for review filed May 7, 1958. (R. 63.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

¹ During the pendency of the actions in the Tax Court, Stanley S. Sayres died and his executors were substituted as parties.

² The following proceedings were consolidated for hearing and decision in the Tax Court: American Properties, Inc., Docket No. 57,748; Stanley S. Sayres, Docket No. 57,749; Madeleine A. Sayres, Docket No. 57,750; and Stanley S. Sayres and Madeleine A. Sayres, Docket No. 57,751. The taxpayers have not petitioned for a review of Docket Nos. 57,749 and 57,750 which involved a salary deficiency for 1948. (R. 25, 61.)

QUESTION PRESENTED

Whether the Tax Court erred in holding that expenditures made (and certain depreciation allowances taken) by taxpayer, American Properties, Inc., in connection with designing, constructing, maintaining, and racing speedboats, were not deductible business expenses within the meaning of Section 23(a) of the Internal Revenue Code of 1939, but rather were personal hobby expenses of the corporation's sole stockholder, the taxpayer Stanley S. Sayres and his wife Madeleine A. Sayres, and therefore were taxable to them as personal income.

STATUTES AND REGULATIONS INVOLVED

These are set out in the Appendix, *infra*.

STATEMENT

The facts as found by the Tax Court (R. 27-40) may be summarized as follows:

Stanley S. Sayres and Madeleine A. Sayres were husband and wife during the years in issue and up to the time of his death on September 16, 1956. Stanley was in the automobile business and in 1931 he purchased the Williams Auto Company in Seattle changing its name to American Properties, Inc. He owned all but one qualifying share of stock in this corporation. Stanley, during the years in issue, was the principal stockholder of the American Automobile Company which operated an automobile dealership in Seattle in and on premises owned by American Properties, Inc. (R. 27-28.)

Stanley³ was interested in outboard motor boat racing prior to his moving to Seattle in 1931, and had a long standing and continuing interest in speed. It was his desire to drive a boat faster than any other person. (R. 28.)

Subsequent to his moving to Seattle in 1931 the taxpayer for several years did not engage in boat racing. However, at some time prior to 1948 he purchased a used racing boat which had previously attained a speed of 80 m.p.h. and named it Slo-Mo-Shun. Thereafter he built Slo-Mo-Shun II and Slo-Mo-Shun III. In the design, construction, operation, and maintenance of Slo-Mo-Shun III, the taxpayer retained technical assistance of experts who were recognized as outstanding in their fields. Ted Jones, his boat designer, was employed as an engineer with an airplane company, and his work for the taxpayer was done at nights, on weekends, and on holidays. Anchor Jensen, of the Jensen Motor Boat Company, was the builder. The taxpayer, Jones, and Jensen attended the 1948 Gold Cup races in Detroit in August, 1948, and after their experience with the first Slo-Mo-Shun and Slo-Mo-Shun II and III they recognized the tremendous room for improvement in the designing of racing boats and that there were possibilities of profits to be made in the designing, construction, and sale thereof. At that time they considered also the possibility that the Navy might be-

³ Stanley is hereinafter referred to as the taxpayer and American Properties, Inc., by its name or as the corporation.

come interested in the basic design of their boats and might become an important customer. Jones proceeded to design Slo-Mo-Shun IV which would be revolutionary in the field of unlimited hydroplane boats. He used the identical design which he had used for years in building and racing limited class boats. By August, 1949, Jones and the taxpayer concluded that Slo-Mo-Shun IV, which was then in the process of construction, would prove to be far superior to boats currently being used. (R. 28-29.)

The taxpayer consulted his attorney, his accountant, and his financial adviser, an official of the Seattle-First National Bank, who all agreed on the profit possibility in the designing, building, and sale of boats. The banker advised against the undertaking in an individual capacity. In discussions with the attorney the taxpayer suggested that inasmuch as the articles of incorporation of American Properties, Inc., already contained provisions which would authorize the construction and sale of boats and marine supplies or engines, such corporation might undertake the venture without the necessity of creating a new corporation. (R. 29.)

The minutes of a meeting of the directors of the corporation held on August 31, 1949 (R. 29), contain the following (R. 30-31):

Preliminary discussions had been had with reference to this corporation entering the field of boat building, ownership and management. Counsel reported that the Articles of Incorporation were sufficiently broad to warrant entry upon such a program.

Mr. Sayres in connection with the Country wide interest in power boat racing suggested that "Slo-Mo-Shun III" was in his opinion far superior to the major racing boats; that an improvement in design had been perfected and in his opinion "Slo-Mo-Shun III" was by no means the last word in the field. In other words, there would be continuous improvement and if sufficient time was devoted to experimental and engineering work other boats would become obsolete and the Seattle boat would be the pattern all over the Country.

He suggested that he believed if the Company would enter the field, do the necessary experimental and engineering work that not only was there money to be made in the manufacture and sale of racing crafts, but in the commercial field as well. That he believed the Government would itself be interested in the fastest type of boat that could be manufactured.

It was recognized that there would be substantial experimental cost to lay the groundwork for future development.

He further stated that he was willing to transfer title of Slo-Mo-Shun III to the corporation if the corporation would continue in an endeavor to work out improvements in design and engineering. He particularly suggested that a new improved Slo-Mo-Shun should be designed and built for actual racing use.

Mr. Sayres also advised that he had substantial offers for Slo-Mo-Shun III and had no doubt of the salability of Slo-Mo-Shun the IVth and boats of that design and class.

It was agreed that it was to the best interest of the corporation to enter this new field and

proceed with the construction of a new boat upon the improved design of Slo-Mo-Shun III, all with the end in view of when the time was propitious getting into commercial operation.

Mr. Sayres was authorized to proceed accordingly. (R. 31.)

At this time Slo-Mo-Shun IV was in the process of being built and was launched in October, 1949. (R. 31.)

Some time prior to October 31, 1949, the corporation paid to the taxpayer an amount of \$14,690.30, which was the amount that had been expended by him in the construction of Slo-Mo-Shun III and of partial construction of Slo-Mo-Shun IV. (R. 31.)

In 1949 there were no registration or licensing requirements with regard to boats of this character and no patents were taken on the design of these boats. The taxpayer did not enter into any formal document transferring title of either Slo-Mo-Shun III or Slo-Mo-Shun IV to the corporation. (R. 31.)

The taxpayer, in filling out forms with the county assessor of King County, Washington, for personal property tax purposes as of January 1, 1950, and 1951, indicating that he was the owner of Slo-Mo-Shun IV, left blank the part of such forms calling for information as to whether he had transferred title. He belonged to the Seattle Yacht Club and has always been registered with the American Power Boat Association as the owner of Slo-Mo-Shun IV and V. The rules of that association provided, among other things, that each boat entered for a sanctioned race must be the bona fide property of the person

in whose name she is entered, who must be a racing member of the association and a member of a club belonging to the association; that corporations or business concerns may not enter sanctioned races (although they may be members of the association) and may only enter a boat as the bona fide property of a club member who is also a racing member of the association, either by ownership or by charter. (R. 31-32.)

In June of 1950, Slo-Mo-Shun IV, driven personally by the taxpayer on Lake Washington, established a new world straight-away speed record of 160 m.p.h., breaking the 11-year-old record of 141 m.p.h. Recognizing the capabilities of this boat and the possibility of still further improvements of design in a model to be built, the taxpayer sought a contractual arrangement which would include Ted Jones, the designer, and Anchor Jensen, the builder. However, because of disagreement as to technical engineering principles Jones refused to sign an agreement which would include Jensen as a party. On July 17, 1950, an agreement was executed "by and between AMERICAN PROPERTIES, INC., (and/or S. S. SAYRES) Party of the First Part, and TED O. JONES, Party of the Second Part," which provided that whereas the first party had financed construction of Slo-Mo-Shun III and Slo-Mo-Shun IV and whereas second party designed both of those boats and assisted in development, construction, and testing, the parties agreed as follows: The second party agreed to work exclusively for the first party in the design and development of "GOLD CUP" and "UNLIMITED" classes of

racing boats during the existence of the contract and a period of 1 year thereafter; second party agreed not to disclose to others any basic or essential features of design, construction, or development; first party agreed that when constructing racing boats, only second party would be employed to design such boats and to supervise construction, and that upon all boats sold by first party, in whom title should always rest, second party would receive a fee of \$5,000 or 10 per cent of sale price, whichever was greater, this being in addition to time and material charges such as had been paid in the past; first party agreed that if Slo-Mo-Shun IV should be sold for an amount greater than cost, first party would pay second party 10 per cent of actual net profit after taxes, or a flat sum of \$5,000 whichever was greater, in which case second party would, in consideration thereof, design a new Unlimited class racing boat for first party at no additional fee; both parties agreed that in event of any sale of plans and designs of Gold Cup and Unlimited boats, first party would pay second party a fee of \$2,500 together with traveling expenses and a fee of \$25 per day actually spent in supervising construction. It was provided that the agreement should continue until terminated by written notice of either party, giving 180 days' notice. It was signed by S. S. Sayres as president of American Properties, Inc., and in his individual capacity, and by Jones. (R. 32-34.)

In July of 1950, Slo-Mo-Shun IV, driven by Ted Jones, won the Gold Cup race. Subsequently, Jones was approached by others seeking boats of the design

of Slo-Mo-Shun IV, including Horace Dodge who sought to have two boats built, offering \$50,000 per boat. Jones sought approval of the taxpayer which was refused. (R. 34.)

Lou Fageol, a wealthy sportsman who was one of the top two or three drivers in the country, had driven Slo-Mo-Shun IV on August 2, 1950, and won the Harmsworth Trophy. He drove Slo-Mo-Shun V and won the Gold Cup in 1951. (R. 34-35.)

In August, 1950, the Seattle-First National Bank loaned American Properties, Inc., \$26,000 to be used in operations in connection with the boats. No collateral was given for the loan. (R. 34.)

In February, 1951, construction of Slo-Mo-Shun V was commenced for the purpose of entering the 1951 Gold Cup races. The taxpayer prevailed upon Jones and Jensen to work together in the construction of the boat. The boat was constructed at the premises of the Jensen Motor Boat Company under the supervision of Jones and with the aid of some of Jensen's boat builders. The boat was completed by the end of July, 1951. Jones received \$5,000 for designing Slo-Mo-Shun V in addition to compensation received on an hourly basis for its construction. (R. 34-35.)

In 1952 Slo-Mo-Shun IV, driven by Stanley Dollar, a wealthy man of the Stanley Dollar Steamship Lines, won the Gold Cup race. Joe Taggart, who has had as much racing experience as Fageol, also drove the Slo-Mo-Shun boats in competition. In 1953 and 1954 either Slo-Mo-Shun IV or Slo-Mo-Shun V won the Gold Cup races. The Slo-Mo-Shun boats have also won the Martini-Rossi Trophy for the fastest heat in

a Gold Cup race and the Aaron DeRoy Plaque for the fastest over-all race average. The taxpayer's name appears on the Gold Cup as the winner and the various trophies which were won by Slo-Mo-Shun boats were kept at the Seattle Yacht Club. There were no cash prizes in racing these boats. (R. 35.)

The taxpayer did not himself personally drive any of the boats in closed course competitive races, such as the Gold Cup or the Harmsworth races. He did drive in speed competition, as in 1950 when he broke the world's straightaway speed record. (R. 35.)

In November of 1951, Ted Jones left Seattle and went east to work as a boat designer for another concern and ceased to operate under the agreement of 1950. No formal notice of termination of the contract was ever given by either party. Because he felt restrained by the contract of 1950, Jones did not, for a number of years, build any boats for others of the design of the Slo-Mo-Shun boats, although he had many opportunities to do so. However, commencing in January, 1954, he did design a number of boats for various individuals throughout the country, employing the design of the Slo-Mo-Shun boats. In 1956, there were about 20 boats eligible for competition in the unlimited class, of which all but 4 were of the basic Slo-Mo-Shun design, none having been sold by the taxpayer or American Properties. (R. 35-36.)

Members of the crew of the various Slo-Mo-Shun boats included highly skilled technicians who worked in their spare time since they were full time employees of other organizations. None of them was employed by either American Properties, Inc., or

American Automobile Company. Jones was compensated for designing the boats and Jensen was paid for his work in building them. (R. 36.)

The principal construction work took place at the Jensen Motor Boat Company, but the engine work was done at the premises of American Properties, Inc., then under lease to American Automobile Company, where there was a machine shop for assembling engines, and engines and parts were stored at these premises. The small handtools which were used were the properties of American Properties, Inc. Only occasionally was equipment of American Automobile Company used, and an electric hoist which was used was not the property of American Automobile Company. (R. 36.)

All costs of completing and operating Slo-Mo-Shun IV and the costs of building and operating Slo-Mo-Shun V were borne by the corporation, including the expenses incurred in racing them, such as traveling expenses of the crew to Detroit in 1950. (R. 36-37.)

The building owned by the American Properties, Inc., was located about $1\frac{1}{2}$ to 2 miles from the nearest navigable body of water. Slo-Mo-Shun III was moored at a dock at the taxpayer's residence on Lake Washington. Later the taxpayer constructed another residence on Lake Washington to which he moved in December 1950, and the Slo-Mo-Shun boats were then housed in the boathouse at such residence. At times the boats were housed at the Jensen Motor Boat Company, which is on Lake Washington about 5 miles from the taxpayer's new residence. (R. 37.)

Greater Seattle, Inc., a nonprofit, publicly subscribed corporation which promoted the annual Seafair and other sporting events, sponsored campaigns to raise money for the operation of the Slo-Mo-Shun boats because of the advantage to Seattle of bringing the Gold Cup race to Seattle. In 1950 the amount contributed by Greater Seattle, Inc., for this purpose was \$6,912.15. This contribution, whether paid to the taxpayer in the first instance, or to the corporation, was ultimately received by the corporation to defray part of the expense of operating Slo-Mo-Shun IV. In subsequent years other contributions were also received from Greater Seattle, Inc., through campaigns for public subscription. In sponsoring campaigns for raising money for this purpose, Greater Seattle, Inc., held the taxpayer out as the owner of the boats. Newspaper articles also consistently referred to the taxpayer as the owner of the boats. The official programs of the Gold Cup races listed him as the owner. (R. 37-38.)

The taxpayer has never sold any of the Slo-Mo-Shun boats or any designs therefor. After Slo-Mo-Shun IV had been constructed, some civilian representatives of the Navy Department examined it and observed it in action. There was no subsequent indication that the Navy would be interested. (R. 38.)

In its income tax returns for the calendar years 1949 and 1950 the corporation showed its principal business activity as "Real Estate" and "Lessor of Building," respectively. It reported net income of \$8,423.26 in 1949 and a net loss of \$1,561.41 in 1950. Its returns show that it had surplus at December 31,

1949, of \$74,659.49 (of which \$37,497.43 was earned surplus) and at December 31, 1950, surplus of \$71,260.73 (of which \$34,098.67 was earned surplus). (R. 38.)

In the calendar year 1949 the corporation expended \$2,155.56 in operation and maintenance of the boats, which it deducted on its corporate tax return as business expenses. In addition, the corporation expended \$561.39 as additional boat expense which it did not deduct on the corporate return. (R. 38.)

For the calendar year 1950 the corporation expended \$19,300.58 for operation and maintenance of the boats and deducted on its return the amount of \$12,388.43 (after offsetting the contribution from Greater Seattle, Inc., in the amount of \$6,912.15). In the return there was included \$1,000 as income from endorsement of an oil product. (R. 38-39.)

The corporation capitalized on its books and its returns for 1949 and 1950 the amounts expended for construction of the boats and related equipment (including the amount of \$14,690.30 which was paid by the corporation to the taxpayer as hereinabove stated). In the 1949 return the balance sheet at the end of the year includes in depreciable capital assets the amount of \$18,609.16 for boats and equipment, but no depreciation was claimed. For 1950 the amount of capitalization of boats and equipment at year end was \$22,323.37 upon which depreciation was taken in the amount of \$5,830.84. The Commissioner determined that the boating activities of the corporation were not carried on as a business for profit and disallowed the expenditures for operation and main-

tenance of boats in 1949 and 1950, and the item for depreciation in 1950. The Commissioner, therefore, included as additional income of the individual taxpayers all amounts expended by the corporation in connection with the boats. Inasmuch as the individuals were on a fiscal year ending October 31, whereas the corporation was on a calendar year basis, the Commissioner determined the amounts which had been expended during the taxable years of the individuals. For the fiscal year ended October 31, 1949, the Commissioner attributed additional income to the individuals in the amount of \$16,401.51, consisting of \$1,149.82 of disallowed corporate expenses to October 31, 1949, \$561.39 representing additional boat expense paid by the corporation and not deducted on the corporate return, and \$14,690.30 representing the amount paid to the taxpayer by the corporation and capitalized on the corporate return. For the fiscal year ended October 31, 1950, the Commissioner attributed additional income to the individuals in the amount of \$16,595.31, consisting of \$1,005.74 expended by the corporation as boat expenses from November 1 to December 31, 1949, \$7,956.50 of net expenses from January 1 to October 31, 1950, and \$7,633.07 expended during the year ended October 31, 1950, and capitalized by the corporation. (R. 39-40.)

On June 29, 1951, the corporation filed a claim for refund of taxes for the year 1949, based upon the carryback of a claimed net operating loss for 1950. On August 19, 1952, the corporation filed another claim for refund for the year 1949, based upon a claim that it understated its net operating expenses

by the amount of \$561.39 referred to hereinabove. (R. 40.)

The Tax Court, in upholding the determinations of the Commissioner, found that the activities of the taxpayer and the corporation during the years in question with respect to the boats were not conducted with the intention of making a profit and such activities did not constitute the conduct of a trade or business by either the taxpayer or the corporation. (R. 40.)⁴

SUMMARY OF ARGUMENT

The questions of what is or what is not a trade or business and whether particular expenditures were proximately related to the carrying on of a trade or business are factual. The burden of bringing the expense deduction within the provisions of the statute is upon the taxpayer.

The courts have held that in a factual situation the lower court's findings will not be set aside unless clearly erroneous and unless the ultimate conclusion is adduced from an erroneous view of the law.

A review of the record by this Court will demonstrate that the taxpayers did not carry their burden of proof and that the Tax Court's findings that the boat venture was not a business, but rather a personal hobby, are not only free from clear error, but

⁴ The Tax Court also ruled adversely to the individual taxpayers on a second issue concerning omissions of salary income and additions for negligence in the year 1950 (Tax Court Docket No. 57751, R. 60), but taxpayers do not raise this issue in this Court (Br. 3).

are warranted fully when considered in the light of the decided cases on the subject.

The taxpayers contend that a profit motive was present, that the boat venture was conducted for the purpose of financial gain, and therefore, the expenditures made in furtherance thereof were incurred in carrying on a trade or business and are deductible under the statute.

The facts of record are contrary to such contentions on the part of the taxpayers, and show, among other things: (1) taxpayer was a prominent sportsman who gained national fame as an owner and driver of high speed power boats and he engaged in motor boat racing as a hobby for many years prior to the years in issue; (2) in 1949, he attempted to shift the financial burden to one of his corporations, although he continued to refer to the activity as his hobby and held out to the public that he personally was expending large sums in furtherance thereof; (3) in subsequent years, only two unlimited class racing boats were constructed and placed in competition, winning many top national awards; (4) after this, numerous offers were received for the design and construction of the boats, but, all were turned down by taxpayer; and (5) no attempt was ever made to sell any boats and no financial gain was realized.

The Tax Court exercised its function with care and its findings are amply supported by the record and its decisions should be affirmed.

ARGUMENT

The Evidence Supports the Tax Court's Holding That Expenditures Made (and Certain Depreciation Allowances Taken) By Taxpayer, American Properties, Inc., In Connection With Designing, Constructing and Racing Speed Boats, Were Not Deductible Business Expenses, But Rather Were Personal Hobby Expenses of the Corporation's Sole Stockholder, the Taxpayer Stanley S. Sayres and His Wife Madeleine A. Sayres, and Therefore Taxable To Them As Personal Income

A. General

The principal issue for determination on this appeal is whether the Tax Court erred in finding that the boat venture was not carried on for the purpose of realizing a profit, but rather was conducted as a hobby of the taxpayer, Stanley Sayres.

The taxpayers contend (Br. 24-25) that a profit motive was present, that the activities of designing, building, maintaining and racing boats were conducted for the purpose of financial gain, and therefore the expenditures made in furtherance of these activities were incurred in carrying on a trade or business and are deductible under the statute.

Section 23(a)(1)(A) of the Internal Revenue Code of 1939 (Appendix, *infra*) provides that in computing net income "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *" may be deducted. On the other hand, Section 24(a)(1) (Appendix, *infra*) of the 1939 Code provides that in computing net income "personal, living, or family expenses * * *" may not be deducted; and, under

well settled principles, capital expenditures are not deductible. *Shipp v. Commissioner*, 217 F. 2d 401 (C.A. 9th), and cases there cited.

The Tax Court found as a fact that (R. 40):

The activities of the petitioner and the corporation during the years in question with respect to the boats were not conducted with the intention of making a profit. Such activities did not constitute the conduct of a trade or business by either petitioner or the corporation.

The question of what is or what is not a trade or business is factual, and the lower court's findings if based upon substantial evidence (and not adduced from an erroneous view of the law) will not be set aside unless clearly erroneous. *Higgins v. Commissioner*, 312 U.S. 212, rehearing denied, 312 U.S. 714; *United States v. Gypsum Co.*, 333 U.S. 364, 395, rehearing denied, 333 U.S. 869; *McDonald v. Commissioner*, 323 U.S. 57; *Morton v. Commissioner*, 174 F. 2d 302, 303 (C.A. 2d). See also Section 7482(a), Internal Revenue Code of 1954, and Rule 52(a), Federal Rules of Civil Procedure.

One of the important factors in determining the existence of a business is the presence or absence of a profit motive and such determination is likewise factual.⁵ *Helvering v. Nat. Grocery Co.*, 304 U.S.

⁵ The intention to profit must be the primary or dominant purpose and incidental expectation or hope of the venture being profitable is not sufficient to constitute the operation of a business (*White v. Commissioner*, 227 F. 2d 779 (C.A. 6th), certiorari denied, 351 U.S. 939; *Coffey v. Commissioner*, 141 F. 2d 204 (C.A. 5th)); and the activity must not be

282, 289, rehearing denied, 305 U.S. 669. However, in making the ultimate finding as to whether the particular activity constitutes a trade or business the courts have considered, *inter alia*, taxpayer's normal and regular activities, his financial position, the extent and nature of the alleged business venture (particularly its relation to both taxpayer's regular operation and his outside interest), the financial record of the operation during all of the year of its existence, and the extent of taxpayer's activities in carrying on the venture as a commercial enterprise. *Brodrick v. Derby*, 236 F. 2d 35 (C.A. 10th); *Coffey v. Commissioner*, 141 F. 2d 204 (C.A. 5th); *Ewing v. Commissioner*, 213 F. 2d 438 (C.A. 2d); *Thacher v. Lowe*, 288 Fed. 994 (S. D. N.Y.). As the Fourth Circuit said in *Cecil v. Commissioner*, 100 F. 2d 896, 899:

The taxpayers' intention is important (*Commissioner v. Field*, 2 Cir. 67 F. 2d 876, 877) but not necessarily controlling, as the nature of the enterprise and its financial results may be even more important.

Taxpayers make no contention, and indeed could not sustain a contention, that the expenditures in question were nonbusiness expenses paid or incurred for the production or collection of income (see Internal Revenue Code of 1939, Section 23(a)(2) (26 U.S.C. 1952 ed., Sec. 23)). But the Treasury Regulations dealing with such nontrade or nonbusiness

conducted primarily for pleasure, exhibition or social diversion (*Deering v. Blair*, 23 F. 2d 975 (C.A. 10th); *Ewing v. Commissioner*, 213 F. 2d 438 (C.A. 2d)).

expenses are illuminating, in that they mark out a standard equally applicable to trade or business expenses and, indeed, express clearly the rule which the cases have applied in respect to claims of trade or business expense deductions, and which distinguishes a hobby from a profit-making enterprise. Thus Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939, reads:

Sec. 29.23(a)-15. *Nontrade or Nonbusiness Expenses.*—

* * * *

(b) * * *

Capital expenditures, and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case, including the record of prior gain or loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

* * * *

Finally, the courts have held consistently that in a situation in which there is a claim for a deduction under the statute the taxpayer must assume the burden of proof and bring himself clearly within the scope and meaning of the section relied upon to support his claim. *Lykes v. United States*, 343 U.S. 118; *Deputy v. du Pont*, 308 U.S. 488; *New Colonial Co. v. Helvering*, 292 U.S. 435; *Welch v. Helvering*, 290 U.S. 111; *Commissioner v. Peurifoy*, 254 F. 2d 483 (C.A. 4th).

A review of the record by this Court will demonstrate that the taxpayers did not carry their burden of proof and the Tax Court's findings that the boat venture was not a trade or business, but rather a personal hobby, are not only free from clear error, but are clearly warranted by the record when considered in the light of the decided cases on the subject.

B. Not a Business but a Hobby

The Commissioner does not contend, as taxpayers seem to indicate (Br. 23-25) that an operation calling for the design and construction of boats cannot be carried on as a trade or business; but, only submits that under the evidence in this case, it can be held (and was properly held herein) that the expenses incurred by American Properties in 1949 and 1950, are not deductible as ordinary and necessary business expenses. Moreover, it is not contended that the particular venture could not be profitable if the taxpayer had operated it in fact as a business for profit. Indeed as the taxpayers point out in their brief (pp. 24-25), Jones went on with the venture after 1951

and made a "handsome profit". In order to constitute a business the venture must not only be entered into with a profit motive but must be carried on primarily and in truth as a business for profit. *Thacher v. Lowe, supra*, p. 995.⁶

We submit that, in spite of taxpayer's testimony (and the testimony of his advisers) to the contrary, the corporation never entered the business of boat design and construction. The Tax Court was warranted in weighing taxpayer's testimony and that of his accountant, lawyer and banker in the light of the evidence. Upon consideration of all the evidence the fact finder concluded that during the years in question the activities of taxpayer and the corporation with respect to the boats were not conducted with the intention of making a profit and that such activities did not constitute the conduct of a trade or business by either the taxpayer or the corporation and the Tax Court so found as a fact.⁷ (R. 40, 51.) The minutes of the board of directors of the corporation

⁶ Taxpayers' citation of *Doggett v. Burnett*, 65 F. 2d 191 (C.A. D.C.) (Br. 25-26), states the basic principle clearly (p. 194) and in doing so supports the Tax Court in the instant case:

The proper test is * * * whether it is entered into and *carried on in good faith* and for the purpose of making a profit, * * *. (Emphasis supplied.)

⁷ Thus in the light of all the circumstances the Tax Court was warranted in concluding that the testimony of taxpayer's accountant, lawyer and banker indicated at the most that taxpayer had under consideration placing the corporation in the boat business and did not at all establish that this had actually been done or that the corporation had actually carried on a business venture for profit.

relied upon so heavily by taxpayers, indicate that commercial operations would not commence until "the time was propitious." (R. 31.)

The taxpayer was interested in speed from his youth and he had raced boats prior to his coming to Seattle in 1931. (R. 27-28, 78.) He evidently did not pursue this hobby activity in Seattle from 1931 to sometime prior to 1948, when he purchased the first Slo-Mo-Shun boat. (R. 28, 79.)⁸ His interest increased after that time and he successively constructed Slo-Mo-Shun the II and III, and had partially constructed No. IV boat in 1949, when the so-called boat venture was discussed. (R. 28-29.) Each boat was a progression of the design of the previous Slo-Mo-Shuns and commencing with III, each was designed by Ted Jones, a well known expert in the field of designing speed or racing boats, and was built by Anchor Jensen at the Jensen Motor Boat Company facilities. (R. 28-29, 80.)

The taxpayer, together with Jones and Jensen attended the 1948 Gold Cup races in Detroit. (R.

⁸ Taxpayer attempts an analogy between his early and continued interest in speed and his entry into the automobile business and his interest in speed and his entry into the boat business. (Br. 23-24.) There is hardly a valid comparison when the facts show that he was in the automobile business for over 20 years during which time he was a major distributor for Chrysler and later a dealer. (R. 78, 116-117.) He no doubt conducted such enterprises in the normal manner, receiving and accepting hundreds (maybe thousands) of offers to purchase his products. (R. 116-117.) In contrast, he turned down every offer received for the design or construction of racing boats and made no sales thereof. (R. 143-145, 207-208.)

28-29.) They had completed the first three Slo-Mo-Shun boats and were convinced that there was room for improvement in the designing of racing boats. In addition, they believed that there was a possibility of realizing a profit from the design, construction and sale of such boats and that the Navy might be interested in the basic design. (R. 29.) The extent of taxpayer's willingness to consider the profit potential of the boats is revealed by his subsequent action in refusing to consider *any* offers for the designing or construction of the boats, particularly those offers from persons who wanted to race the boats (R. 164-165, 168); and by the following testimony (R. 82-83):

There is no money in racing in the Gold Cup races. There never has been. I would like to add that Jones and I were both agreed that there might be another field even more important than just race boats, and that is if the Navy should ever want a really high speed, well, what we might call a super PT boat. Now, whether the Navy is ever going to want one or not, I don't know.

This statement shows the importance taxpayer attached to racing for pure pleasure; and, that he might be willing to consider naval use of his design, but, despite the connotation to the contrary, and in view of his subsequent actions, he was unwilling for anyone else to have access to the Slo-Mo-Shun boat. As late as the spring of 1956, the date of the hearing below, the taxpayer was still not aware of the interest the Navy might have in the Slo-Mo-Shun boats. (R. 82-83.)

In the summer of 1949, and while Slo-Mo-Shun IV was under construction, taxpayer consulted with his advisers concerning further development of the basic design and the possibilities of future profits. (R. 29.) He was aware that the articles of incorporation permitted American Properties to construct and sell boats (R. 162-163) and apparently upon the advice of his banker (R. 29) decided to utilize the corporation in carrying on future activities, including the design, maintenance and operation of the Slo-Mo-Shun boats.⁹ At a meeting of the board of directors of the corporation, it was decided "to enter this new field and * * * when the time was propitious [for] getting into commercial operation." (R. 29-31.) Thereafter, taxpayer purported to transfer Slo-Mo-Shun III and Slo-Mo-Shun IV to the corporation. (R. 31.) While it is well established that a corporation is a distinct and separate entity from its stockholders, it cannot be overlooked that taxpayer was the sole stockholder of the corporation, that he attended and no doubt conducted the meeting, and that he signed the minutes of the meeting in August of 1949. (R. 27, 86, 92, 93.) The court was justified in looking through the corporate set-up and observing the taxpayer as the real party in interest. *Wisc. Memorial Park Co. v. Commissioner*, 255 F. 2d 751

⁹ Inasmuch as the actual construction was carried on at the Jensen Motor Boat Company Yard, under the direction of Anchor Jensen, it does not seem likely that American Properties was ever considered in this phase of the operation. (R. 28, 80, 120.) Taxpayer indicated in his testimony that he was interested in designing boats and that someone else would have to build them. (R. 82.)

(C.A. 7th); *Helvering v. Scottish American Inv. Co.*, 139 F. 2d 419, 422 (C.A. 4th).

The fourth boat was completed by Jensen in the fall of 1949 (R. 31), and in the summer of 1950, while being driven by taxpayer it established a new world straightaway speed record (R. 32). Thereafter, on July 17, 1950, taxpayer and Jones entered into a contract calling for Jones to design boats exclusively for the taxpayer and the corporation. (R. 32-34, 94-95.) It was contemplated that the contract was to be between the corporation and Jones, but, Jones insisted that, in addition, taxpayer sign it personally. Under this agreement the taxpayer agreed to utilize the services of Jones exclusively in designing racing boats and would pay him \$5,000 or 10% of the sales price of each boat *sold*, and in addition would pay time and material charges as in the past. Jones agreed to design racing boats as requested, to disclose to no one the essential features of the design, and to design a new unlimited class racing boat for taxpayer if Slo-Mo-Shun IV was sold at a price greater than cost. The agreement was to remain in effect until terminated by written notice of either party. (R. 33-34.) A few days after the contract was signed Jones won the Gold Cup race for 1950 (R. 34) and was immediately besieged with offers for duplicate boats (R. 211).¹⁰ He and the taxpayer had been enthusiastic about the basic design and were sure that the boat would perform remarkable feats; however, others considered it to be a "backyard

¹⁰ At least two specific offers were for a price of \$50,000 per boat. (R. 207-208.)

freak". (R. 211.) Nevertheless, the boat established a new straightaway record and won the Gold Cup, and inasmuch as Jones was interested in making money from his design under the contract (R. 210) he took some of the offers to taxpayer and asked him if they could built boats to fill the offers. The taxpayer immediately refused, saying that they would not be building for anyone. (R. 208.) Taxpayer's continued refusal to consider offers and the other facts of record indicating his desire to be alone in the field (discussion, *infra*),¹¹ give credence to the following statement of Jones as to why the offers were rejected (R. 208):

Well, I would have to assume so that there would be no more boats in Slo-Mo-Shun's speed and maneuverability for competition. That is what I gathered from the conversation.

Thus, in the summer of 1950, taxpayers' and Jones' greatest expectation had been realized. Their "back-yard freak" had performed remarkable feats and was widely acclaimed.¹² As the lower court said in its opinion (R. 49):

It would seem that the "propitious" time for actively going into production and sale would

¹¹ Taxpayer insisted in the contract that Jones design for him a new unlimited class boat if one of the Slo-Mo-Shuns was sold. (R. 33.) There is evidence that taxpayer would not sell unless he had another Gold Cup defender, partly because he would lose face in Seattle. (R. 143-145.) And, he evidently felt that Jones was being disloyal in even considering the sale of the Slo-Mo-Shun design. (R. 210-211.)

¹² The boat also won the Harmsworth Trophy in August of 1950. (R. 34.)

have been in 1950 after winning the Gold Cup race.

The corporation did not go into production at that time or even begin preparations for further construction. (R. 34-35, 48-49, 206.)

It is submitted that taxpayer's action in the summer and fall of 1950, despite his testimony, would have been different if he had any intention of making a profit from the design or sale of boats for either himself or the corporation of which he was the sole owner.¹³ Even more clearly his actions would have been greatly different, if profit had in fact been his primary purpose and, as seen, the burden was his to

¹³ The lower court was not bound to the testimony of the taxpayer as to his intent because such testimony was refuted by other circumstances in connection therewith. *Penna. R. Co. v. Chamberlain*, 288 U.S. 337, 340; *Taitt v. Commissioner*, 166 F. 2d 697, 698 (C.A. 5th); *Foran v. Commissioner*, 165 F. 2d 705 (C.A. 5th). Particularly is this so because of the opportunity of the lower court to observe witnesses and weigh their testimony in the light of the whole record. *Pool v. Commissioner*, 251 F. 2d 233 (C.A. 9th); *Helvering v. Nat. Grocery Co.*, 304 U.S. 282; *Heil Beauty Supplies v. Commissioner*, 199 F. 2d 193, 195 (C.A. 8th). Unless the record shows that an honest effort was made to conduct a profitable business (*Thacher v. Lowe, supra*) and that the venture was conducted in good faith (*Coffey v. Commissioner, supra*), the expense incurred in or the losses from the venture may not be considered for income tax purposes. In *Crown Iron Works Co. v. Commissioner*, 245 F. 2d 357, the Eighth Circuit had this to say concerning the lower court's function in determining intent (p. 360):

The question of intent, if at all doubtful * * * is a question of fact for the trial court, and only becomes a question of law for a reviewing court if the evidence is all one way or so overwhelmingly one way as to have no doubt as to the fact. * * *

establish that profit was his primary purpose. The Tax Court was surely warranted in finding that he failed to sustain this burden.

It was not until February of 1951 that any activity was undertaken to design and construct an additional boat. This effort was directed at developing a further improvement in the basic design and to construct a boat to represent the taxpayer at the Gold Cup races of 1951. (R. 34, 100, 207.) The boat was designed by Jones and constructed at the Jensen Boat Company yard. (R. 34.) Both taxpayer and Jones considered that the boat was designed and constructed under the contract between the two of them. And, in addition to the usual payment for time worked and materials, Jones received a fee of \$5,000. (R. 100, 206, 207.) A careful review of the contract terms (R. 33-34) will reveal that no provision was made for the payment of \$5,000 as a fee to Jones for a boat designed and constructed for taxpayer. He would no doubt be entitled to the usual hourly fee and expenses. Jones considered the arrangements to be for business purposes (and the taxpayer would have the court believe he felt likewise); however, the terms provided for Jones to receive a fee of \$5,000 or 10% of the purchase price if higher, for each boat *sold*. (R. 33-34.) All offers received after the design had been established were refused by the taxpayer, and under such conditions it was not possible for Jones to realize any profit from the venture. Taxpayer paid Jones for Slo-Mo-Shun V under the terms of the contract as if it had been sold by the corporation.

The new boat, Slo-Mo-Shun V, won the Gold Cup race of 1951, being driven by Lou Fageol, one of the top drivers in the country. (R. 35.)¹⁴

In November of 1951, Jones left the Seattle area and carried on his pursuit of designing boats, except those involving the basic design of the Slo-Mo-Shun boats. (R. 35.) He was ready and willing to design additional boats for the taxpayer under the terms of the contract but no other boats were discussed. (R. 206-207.) The completion of V took care of the 1951 season as far as taxpayer was concerned and he "didn't need any more at that time." (R. 207.) After winning the Gold Cup in 1950, taxpayer evidently did not believe the time was right to enter the business of designing, constructing and selling boats; likewise, after his successes in 1951, he gave no evidence of intending to engage in business for profit. The taxpayer no doubt had what he wanted in boats IV and V—racing one or the other, he won four straight Gold Cup races and many other prizes and honors. (R. 35.) In this regard, it is not disputed that racing boats in competition is an effective way of proving their worth and selling potential. However, taxpayer's activities over those years (1949-1953) establish conclusively that he was pursuing his

¹⁴ The Slo-Mo-Shun boats won the Gold Cup in 1952 and 1953, and won many other important trophies during the years 1950-1953. Four different men drove the Slo-Mo-Shun boats to their victories in 1950-1953, i.e., Ted Jones, Lou Fageol, Joe Taggart and Stanley Dollar. None of these men were employed by the taxpayer or the corporation (except Jones for the short while in 1951) and they were either wealthy sportsmen or top race drivers. (R. 34-35, 122-123.)

hobby and was not seriously considering the possibilities of profit in the sale of the design.¹⁵

Jones did not give notice of termination of the contract but honored its terms for about three years. (R. 207.) He then began to design unlimited class boats, principally using the basic design of the Slo-Mo-Shun boats. Fifteen or so of his boats are in service and all but three or four follow this basic design. (R. 35-36, 206-207.)

This record of the action of the taxpayers over the years (without more) supports fully the Tax Court's statement that (R. 47):

* * * we do not doubt that the petitioner and others held the belief that there was a profit possibility, we do not believe * * * that there was an intention or motive of immediately embarking upon a business venture. Rather, we believe that the parties had in mind merely the possibility of entering into a commercial venture at some future time when it might be deemed expedient to do so. The evidence shows that this never did eventuate.

A study of the court's findings and opinion shows that, in arriving at the above conclusion it did not overlook any of the facts of record, including evi-

¹⁵ It is undisputed that speed boat racing was taxpayer's hobby up to 1949 (R. 44, 67-68); and that after that time, as he admitted, driving and testhopping boats was a hobby (R. 100-101). In addition, it is important to note that in August of 1949, according to minutes of the meeting of the board of directors of American Properties, taxpayer "had no doubt of the salability of Slo-Mo-Shun the IVth and boats of that design and class". (R. 30-31.)

dence of a loan of \$26,000 in 1951 to the corporation to use in the boat operation (R. 34); a loan made by a bank whose loan officer had been taxpayer's financial adviser for 20 years; a loan made to a corporation which had a surplus of over 70 thousand dollars in 1949 and 1950, and whose sole stockholder was a successful businessman and leading civic leader in Seattle (R. 38, 113, 125, 126).¹⁶

In completing the picture of taxpayer's activities and in arriving at a determination of his intention to operate a business for profit, the court was authorized and required to consider, in addition to evidence of the conduct of the venture (which has been discussed in detail *supra*), his financial and social position and his regular business and outside activities. *Coffey v. Commissioner, supra*; *Ewing v. Commissioner, supra*. Among other things, the following bear upon these considerations, and together with the record of the operation of the boat venture throughout 1949, 1950 and 1951 and subsequent years, furnish ample justification for the ultimate finding that the expenses were in furtherance of taxpayer's personal hobby and not in the conduct of a trade or business for profit.

The taxpayer was a prominent sportsman who gained national fame as an owner and driver of high

¹⁶ The Tax Court was not unmindful of the question as to whether the title to the boats passed to and lodged in the corporation. It noted properly that the answer to the question itself is not decisive, "but is merely one of the factors involved in the more important question of whether the corporation did enter into a true business venture of exploiting these racing boats for profit." (R. 45.)

speed, unlimited class power boats and was selected as "The Man of the Year" of Seattle in 1950 (a top sports achievement award). (R. 30, 68, 69, 73.) While he did not drive his boats in closed course races, he did drive in competition and established the world's speed record for a straightaway course. (R. 88, 89.) He personally spent large sums of money (at least \$100,000) in the design, construction, maintenance and operation of his unlimited class boats. (R. 109-113.) Taxpayer advised a newspaperman in 1953 that he personally spent more than \$100,000, that no one had advised him of how to get any tax benefit therefrom; that he personally financed "entirely" the costs of operating the boats in the Gold Cup races in 1950 and 1951 (R. 109); that he personally made up the loss in the expenses of the Gold Cup race in 1952; and that any deficit in 1953 would be absorbed by him (R. 111, 113; Exs. K, L). Earlier (June, 1952), in an interview with a newspaperman (R. 129-130; Ex. N) he had referred to the design and operation of the boats as his personal hobby and of the fact that it was becoming very expensive. It appears as a result of this interview and the report thereof, that Greater Seattle undertook to help finance future operations. (R. 130; Ex. O.) In these and other ways taxpayer held himself out as the owner and operator of the boats, and referred to such activities as a hobby. (R. 127-130, 135-136; Exs. K, L, N, O.) It seems clear that the general public in the Seattle area considered the taxpayer to be the owner of the boats and that racing speed boats was his hobby; and taxpayer made no serious effort

to dispel such an impression. (R. 127-128, 135-136.) This understanding on the part of the public was evident in the response to the annual campaigns conducted each year by Greater Seattle¹⁷ to assist taxpayer in defraying his expenses of preparing for and racing the Slo-Mo-Shuns in competitive races. (R. 130, 133, 134, 135.) In conducting such campaigns and in programming the races in the water shows, Greater Seattle publicized the taxpayer as the owner of the boats and he did nothing to deny such personal ownership. (R. 136, 138, 139.) The Tax Court was surely warranted in doubting that a man of taxpayer's community standing would have permitted public subscriptions on the public understanding that the operation was a non-profit hobby, if such had not been the fact. (R. 50.) Furthermore, the taxpayer listed himself as owner of the boats in 1950 and 1951 in executing forms for personal property taxes (R. 31-32); registered himself as the owner of the boats with the Seattle Yacht Club and the American Power Boat Association (R. 32); and had his

¹⁷ Greater Seattle was a non-profit corporation organized to sponsor sporting events and other functions in the interest of building up the City of Seattle. Concerning the campaign to assist him, taxpayer testified (R. 135-136):

Q. [By Mr. Cromwell.] Did Greater Seattle ever sponsor any campaigns to raise money for you to operate these boats, Mr. Sayres?

A. Yes.

Q. Did they advise the public that the American Properties, Inc. owned these boats?

A. I don't think so.

Q. Did they hold you out as the owner of the boats?

A. I can't answer that flatly, I would assume, Yes.

name placed on all cups and other trophies won by the Slo-Mo-Shuns (R. 123, 126).

Finally, it must not be overlooked that neither the corporation nor the taxpayer ever constructed any boats for sale; never made an effort to sell any boats, and in fact never sold any boats (although taxpayer had offers to do so).¹⁸ Taxpayer considered the boats to be his and he was not interested in disposing of any of them. There is no question here, as there is in most cases involving this issue, of whether the sales or income over the years is of sufficient volume to constitute a business. Here there was no production, no sales, and thus, no income. It is not possible to even consider the principle that in order to constitute a bona fide business, the gross receipts must have substantial relation to the expense of operation. *Cecil v. Commissioner, supra*, p. 901.

If this Court upholds the Tax Court's finding that the expenditures made by the corporation in the boat venture were for the personal hobby of the taxpayer, then it follows that the Tax Court was correct in holding that the expenses were properly chargeable to the individual taxpayers as income. As noted by the lower court in its opinion (R. 52-53), "It is well settled that payments made by a corporation on be-

¹⁸ As a matter of fact taxpayer had received many offers to sell his boats and the designs before he conceived the idea of shifting the burden of financing his hobby to one of his corporations. The minutes of the meeting of the directors of American Properties in August, 1949, contains this notation (R. 30-31): "Mr. Sayres also advised that he had substantial offers for Slo-Mo-Shun III * * *."

half of its stockholders may constitute taxable dividends to the stockholder." Particularly is this true if there is no business purpose involved. *Lengsfeld v. Commissioner*, 241 F. 2d 508 (C.A. 5th); *Byers v. Commissioner*, 199 F. 2d 273 (C.A. 8th). The corporation had a surplus at the end of 1949, in the amount of \$74,659.49, consisting in part of \$37,497.43, in earned surplus; and a surplus of \$71,260.73 at the end of 1950, of which \$34,098.67 was earned surplus. (R. 38.) There was no evidence introduced to indicate that the earnings were not available for disbursement to the sole stockholder in the amounts expended in the boat venture, which did not exceed \$33,009 for the two years involved. (R. 217.)

CONCLUSION

We submit that the Tax Court's findings are amply supported by the record and that its decisions are correct and should be affirmed.¹⁹

Respectfully submitted,

CHARLES K. RICE,
Assistant Attorney General.

LEE A. JACKSON,
I. HENRY KUTZ,
C. GUY TADLOCK,
Attorneys,
Department of Justice,
Washington 25, D. C.

OCTOBER, 1958

¹⁹ It is noted that part of the deficiency against the individual taxpayers for fiscal 1950 is not in dispute. (R. 60; Br. 3.)

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition*.—"Gross income" includes gains, profits, and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transactions of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121, Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses*.—

(1) *Trade or business expenses*.—

(A) *In general*.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

* * * *

(1) [As amended by Sec. 121, Revenue Act of 1942, *supra*] *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule*.—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

* * * *

(26 U.S.C. 1952 ed., Sec. 24.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.22(a)-1. *What Included In Gross Income*.—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22(b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

* * * *

Sec. 29.23(a)-1. *Business Expenses*.—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the tax-

payer's trade or business, except the classes of items which are deductible under sections 23(b) to 23(z), inclusive, and the regulations thereunder. * * *

* * * *

Sec. 29.23(1)-1. *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, may be deducted from gross income.

* * *

United States Court of Appeals
For the Ninth Circuit

AMERICAN PROPERTIES, INC., and the Estate of STANLEY
S. SAYRES, Deceased, HAROLD L. SCOTT and A. R.
MUNGER, Executors, and MADELEINE A. SAYRES,
Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR REVIEW OF DECISION OF THE TAX COURT
OF THE UNITED STATES
HONORABLE CRAIG S. ATKINS, *Judge*

REPLY BRIEF OF PETITIONERS

KENNETH P. SHORT

Attorney for Petitioners on Review.

1107 American Building,
Seattle 4, Washington.

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vs.	
COMMISSIONER OF INTERNAL REVENUE, <i>Respondent.</i>	

PETITION FOR REVIEW OF DECISION OF THE TAX COURT
OF THE UNITED STATES
HONORABLE CRAIG S. ATKINS, *Judge*

REPLY BRIEF OF PETITIONERS

Page 17 of respondent's brief states that Mr. Sayres "was a prominent sportsman who gained national fame as an owner and driver of high speed power boats . . . ; in 1949 he attempted to shift the financial burden to one of his corporations . . . "

The fact is, and the record clearly shows, that Sayres had no fame in the racing world of any kind prior to June 26, 1950, when SLO-MO-SHUN IV broke the world's speed record. That boat was built *by the corporation* pursuant to the resolution of August 31, 1949, and was launched in October, 1949 (Tr. 31). The assertion that Sayres, as a prominent sportsman who gained national fame as an owner and driver of high speed power boats, shifted the financial burden thereof to his corporation is clearly untrue.

When the corporate resolution by which American Properties went into the boat venture was passed on August 31, 1949, Sayres was unknown in the racing world. It is easy logic to now look backward at the lack of profit in the venture and refer to the building of SLO-MO-SHUN IV by American Properties as "shifting Sayres' financial burden," if, indeed, he had any such financial burden in August, 1949. The substantial expense in issue in this case was incurred after August 31, 1949.

What was also "shifted" was the entire prospective profit potential of the venture when there was great enthusiasm for the success of the new boat being then built.

At the same page of his brief, respondent asserts that "numerous offers were received for the design and construction of the boats, but, all were turned down by taxpayer; . . . "

There is no reference to any portion of the record, nor can there be, to substantiate this assertion. The Tax Court found that one person made an offer to purchase in 1950 (Tr. 48). Sayres testified that Jones told him that Horace Dodge wanted to buy SLO-MO-SHUN IV, that he did not refuse to sell it, "but I wanted somebody to talk to me directly about it" (Tr. 141) and that if he had sold it in 1950, it would have ended any hopes of going on with the continuing development of the boat (Tr. 142, 145). Jones testified the Dodge offer was for two boats (Tr. 208). In any event there was only one offer, and that was communicated to Sayres indirectly through Jones. In fact, it is not entirely clear whether this proposal was made to Jones individually as a designer or

whether Dodge intended the offer to be to American Properties (Tr. 208).

It will be remembered that this isolated and only "offer" (if it was an offer, it was made in a most circuitous manner) occurred in June, 1950, when American Properties only had one boat of this design.

Whether this was an offer and whether it was refused is probably of negligible significance in the light of the circumstances under which the incident occurred. Respondent from this isolated occurrence, however, proceeds to the much repeated conclusion that the absence of profit motive "is revealed by his subsequent action in refusing to consider *any* offers for the designing or construction of the boats . . . " (Respondent's Brief, page 25—italics not supplied). Respondent seeks to justify the foregoing assertion by citing "R. 164-165, 168." A reference to those pages of the printed record will indicate that they do not relate to the subject matter of the respondent's assertion.

At page 20 of his brief, respondent asserts that petitioners do not contend, and cannot sustain a contention, that the individual taxpayers can deduct the expenses of the boat under Internal Revenue Code, Section 23 (A)(2). Respondent is quite correct that we did not so contend. However, respondent then proceeds as if we did so contend and, having set up the straw man, answers the "argument." We do not feel obliged to reply.

So that there is no misunderstanding about it, petitioners have consistently throughout this proceeding taken the position that either (1) American Properties can deduct the expense of the boat venture under Sec-

tion 23(a)(1)(A) as ordinary and necessary expense of that corporation's trade or business or, in the alternative, (2) that the expenses were nevertheless deductible by the individuals under Section 23(e) since incurred "in a trade or business" or in a "transaction entered into for profit, though not connected with the trade or business." This position of the petitioner is specifically asserted at petitioners' opening brief at pages 27, 36-37.¹

At page 28-30 of the respondent's brief it is asserted that the "propitious" time for actively going into production and sale would have been in 1950 after winning the Gold Cup race and that the corporation did not construct an additional boat until February, 1951. It is true that SLO-MO-SHUN V was not launched until 1951, but the contract for its construction was signed by Jones and petitioner July 17, 1950 (Ex. 1), three weeks after SLO-MO-SHUN IV broke the world's record and one week *before* SLO-MO-SHUN IV won its first Gold Cup.

Respondent seems to be attempting to make some point (Respondent's Brief, page 30) of the fact that the corporation paid Jones \$5,000 for designing SLO-MO-SHUN V although Jones' contract (Exhibit 1) was for \$5,000 or ten per cent of the sales price, whichever was greater; that there was no sale and hence no intention of selling. This somewhat obscure point is made more confusing by the fact that the boat for which the \$5,000

¹The Tax Court in its opinion states (Tr. 53), "The petitioners contend, alternatively, that if the corporation was not engaged in the business then they were, and that the amounts, if taxable to them, would also be deductible by them."

was paid was built in 1951, after the tax years in question, and no evidence appears in the record as to whether that boat was, in fact, sold, although respondent infers that it was not.

Regarded in its true context, the contract with Jones is undoubtedly, together with the corporate resolution, the best documentary evidence of the profit purpose with which the boat venture was launched. This contract, undertaking as it does to pay Jones, in addition to time and materials, \$5,000 or ten per cent of sales price, whichever is greater, on all boats sold would appear to be a most peculiar way to pursue an intent *not* to sell boats or designs and a more peculiar way to pursue a personal "hobby" of racing boats which are *not* for sale. There is no way to reconcile that agreement with respondent's hobby theory.

Sayres knew the boat was a smashing success when he signed the contract, Exhibit 1, promising on behalf of American Properties to pay Jones handsomely for boats that were sold. The unavoidable conclusion is that if Sayres had wanted to eschew profit as his purpose, abandon the idea of selling boats and designs and be the personal king of the racing world as his hobby, June 26, 1950, would seem to have been "the propitious time" to have done so.

On the contrary, seeing the boat had proved itself, he immediately and before it had even entered the Gold Cup race bound Jones to a contract geared to *sales* of boats and designs.

Jones, as respondent's witnesses, testified that the agreement was drawn in anticipation of the sale of boats

or designs and for profit (Tr. 209). It could have no other purpose.

Nor should one lose sight of the fact that it was in August, 1950, that American Properties borrowed some \$26,000 from the Seattle-First National Bank to be used in connection with the boats (Tr. 34).² Chronologically then, this appears: On August 31, 1949, the corporate resolution was passed, the good faith of which is unchallenged, in which the corporation initiated the boat venture; the boat broke the world's record June 26, 1950; the contract with Jones anticipating sales of the boats was July 17, 1950; SLO-MO-SHUN IV won the Gold Cup July 22, 1950; and on August 7, 1950, the Seattle-First National Bank made a normal commercial loan to the corporation to be used by the corporation to finance its boat operations. This, together with the direct evidence from the participants clearly demonstrates that the profit motive was paramount throughout.

The respondent's case, in summary, is simply that the venture did not materialize in profit and *that* is the best evidence. We respectfully disagree. The findings of the Tax Court are clearly erroneous.

Respectfully submitted,

KENNETH SHORT

Attorney for Petitioners.

1107 American Building,
Seattle 4, Washington.

²The Tax Court is somewhat confused about this date. The testimony is clear that it was 1950 (Tr. 172 to 175, Exhibit 6). Although the Tax Court finds as a fact (Tr. 34) that the loan was in August, 1950, in its opinion (Tr. 50) the Tax Court says: "In August, 1951, the corporation borrowed \$26,000 to be used in connection with the boats, but this was after his refusal of offers to buy boats and cannot be considered as indicating a profit motive."

No. 16052

United States
Court of Appeals
for the Ninth Circuit

APACHE POWDER COMPANY, a corporation,
Appellant,

VS.

THE ASHTON COMPANY, INC., CONTRAC-
TORS AND ENGINEERS, formerly Ashton
Building Company and MARDIAN CON-
STRUCTION COMPANY, corporations en-
gaged in a joint venture as Ashton-Mardian
Company and THE TRAVELERS INDEM-
NITY COMPANY, a corporation,
Appellees.

Transcript of Record

Appeal from the United States District Court
for the District of Arizona

FILED

AUG - 4 1958

PAUL P. DERRIN, CLERK

No. 16052

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THE UNIVERSITY OF CHICAGO

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NAMES AND ADDRESSES OF ATTORNEYS

EVANS, KITCHEL & JENCKES,
807 Title & Trust Building,
Phoenix, Arizona,
Attorneys for Appellant.

HALL, CATLIN & MOLLOY,
1010 Valley National Building,
Tucson, Arizona,

CONNER & JONES,
Valley National Building,
Tucson, Arizona,
Attorneys for Appellees.

In The United States District Court
For The District of Arizona

Civil Action No. 967 Tucson

UNITED STATES OF AMERICA, for the Use
of APACHE POWDER COMPANY, a corporation,
Plaintiff,

v.

THE ASHTON COMPANY, INC., CONTRACTORS AND ENGINEERS, formerly ASHTON BUILDING COMPANY, and MARDIAN CONSTRUCTION COMPANY, corporation engaged in Joint Venture as ASHTON-MARDIAN COMPANY; THE TRAVELERS INDEMNITY COMPANY, a corporation; PIONEER CONSTRUCTORS, a corporation; and CONSTRUCTION MATERIALS COMPANY, a corporation,
Defendants.

COMPLAINT

The United States of America, suing herein for the use and benefit of Apache Powder Company, a corporation, alleges:

I.

This action is brought under the Act of Congress of August 24, 1935, c. 642, § 2, 49 Stat. 794, 40 U.S.C.A. § 270b, on the payment bond of the contractor under a contract with the United States of America which was to be and was performed and executed within the District of Arizona.

II.

Apache Powder Company is a New Jersey corporation, authorized to do business in the State of Arizona. The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company are Arizona corporations engaged in a Joint Venture as Ashton-Mardian Company. The Travelers Indemnity Company is a Connecticut corporation, authorized to do business in the State of Arizona. Pioneer Constructors and Construction Materials Company are Arizona corporations.

III.

On or about March 30, 1956, the defendants, The Ashton Company, Inc., Contractors and Engineers, as Ashton Building Company, and Mardian Construction Company, engaged in a Joint Venture as Ashton-Mardian Company, duly entered into a contract in writing with the United States of America, Corps of Engineers, United States Army, wherein and whereby it was agreed that said defendants were to furnish the material and perform the work for the construction and completion of Air Force Station TM-181, a radar station five miles North of Ajo, Pima County, State of Arizona, in accordance with plans and specifications and terms and conditions, therein specifically set forth, in consideration whereof the United States of America agreed to pay said defendants the sum of Two Million Three Hundred Fifty-one Thousand Six Hundred Thirty-seven and no/100ths Dollars (\$2,351,637.00).

IV.

On or about March 30, 1956, pursuant to the Act of Congress of August 24, 1935, c. 642, § 1, 49 Stat. 793, 40 U.S.C.A. § 270a, and pursuant to the terms of the aforesaid contract, said Ashton-Mardian Company, a Joint Venture, as principal, and defendant The Travelers Indemnity Company, as surety, for a valuable consideration, made, executed, and delivered to the United States of America their Payment Bond in the sum of Nine Hundred Forty Thousand Six Hundred Fifty-five and 04/100ths Dollars (\$940,655.04), the condition of which bond, as required by the said Act of Congress, is that the said principal shall promptly make payment to all persons supplying labor and material in the prosecution of the work provided in said contract.

V.

On or about March 30, 1956, said Ashton-Mardian Company, a Joint Venture, as the prime contractor under said contract with the United States of America, entered into a subcontract with defendant Pioneer Constructors for the performance and completion of certain parts of the work, specified in said subcontract, which were to be performed and completed under said contract with the United States of America, in accordance with the plans and specifications and terms and conditions of said prime contract, in consideration whereof said prime contractor agreed to pay to said defendant Pioneer Constructors the sum of Four Hundred One Thousand Two Hundred Seventeen and 83/100ths Dollars (\$401,217.83).

VI.

Upon information and belief, the said Ashton-Mardian Company, as the prime contractor, and defendant Pioneer Constructors, as a subcontractor, under said contract with the United States of America, entered upon the performance of said prime contract and subcontract and furnished labor and material therefor, but, without any notice to Apache Powder Company by any of the defendants and without any knowledge thereof by Apache Powder Company, said subcontract with defendant Pioneer Constructors was terminated on or about November 1, 1956.

VII.

That, without any notice to Apache Powder Company by any of the defendants and without any knowledge thereof by Apache Powder Company, on or about November 1, 1956, said Ashton-Mardian Company, a Joint Venture, as the prime contractor under said contract with the United States of America, entered into a subcontract with defendant Construction Materials Company for the performance and completion of certain parts of the work, specified in said subcontract, which were to be performed and completed under said contract with the United States of America, in accordance with the plans and specifications and terms and conditions of said prime contract, in consideration whereof said prime contractor agreed to pay to said defendant Construction Material Company the sum of Two Hundred Sixty-six Thousand Three Hundred Ninety-one and 66/100 Dollars (\$266,391.66).

VIII.

Upon information and belief, the work to be performed under said subcontract of November 1, 1956, by defendant Construction Materials Company, was identical with the work to be performed under said subcontract of March 30, 1956, by defendant Pioneer Constructors, and said two subcontracts were in fact one and the same subcontract, part of which was performed and completed by defendant Pioneer Constructors and the remainder of which was performed and completed by defendant Construction Materials Company.

IX.

That from and including June 13, 1956, to and including March 12, 1957, on an open account at the special instance and request of defendants Pioneer Constructors and Construction Materials Company, Apache Powder Company, being then informed and believing that Construction Materials Company was a division of Pioneer Constructors, and having reason to believe it was furnishing all of said material to Pioneer Constructors under said subcontract of March 30, 1956, furnished material consisting of explosives and blasting supplies to Pioneer Constructors and Construction Materials Company for use in the prosecution of the work under said subcontracts and said prime contract with the United States of America, of the agreed and reasonable value of Thirty-three Thousand Four Hundred Fifty-three and 71/100ths Dollars (\$33,453.71), which material was delivered by

Apache Powder Company on said radar station job and was used by defendants Pioneer Constructors and Construction Materials Company in the prosecution of the work under said subcontracts and said prime contract with the United States of America.

X.

There remains due, owing, and unpaid to Apache Powder Company from defendants Pioneer Constructors and Construction Materials Company, after all payments and credits have been allowed, upon said material furnished, delivered, and used as aforesaid, the sum of Twenty Thousand Nine Hundred and 69/100ths Dollars (\$20,900.69), no part of which sum has been paid, although payment thereof has been duly demanded.

XI.

The last of said material was furnished and delivered by Apache Powder Company on or about March 12, 1957, and, pursuant to the Act of Congress of August 24, 1935, c. 642, § 2, 49 Stat. 794, 40 U.S.C.A. § 270b, and within ninety (90) days from the date on which the last of said material was furnished and delivered, to-wit, on April 25, 1957, Apache Powder Company gave written notice to Ashton Building Company, Mardian Construction Company, and Ashton-Mardian Company, a Joint Venture, the prime contractor under said contract with the United States of America, stating with substantial accuracy the balance due and amount claimed by Apache Powder Company and

the names of the parties to whom the material was furnished, which notice was served in the manner required by said Act of Congress.

XII.

Upon information and belief, defendant Construction Materials Company and said Ashton-Mardian Company, continued to perform said sub-contract and said prime contract with the United States of America, and performance thereof has been completed, but final settlement of said contract with the United States of America has not been made.

XIII.

That a period of ninety (90) days after the day on which the last of said material was furnished and delivered has expired, and that one (1) year after the date of final settlement of said contract with the United States of America has not expired.

Wherefore, the United States of America, on behalf and to the use of Apache Powder Company, prays judgment against said defendants for the sum of Twenty Thousand Nine Hundred and 69/100ths Dollars (\$20,900.69) with interest, for costs of suit herein incurred, and for such other and further relief as the Court may deem just and proper.

EVANS, KITCHEL & JENCKES,

/s/ By ALFRED B. CARR,

Attorneys for Plaintiff.

[Endorsed]: Filed June 17, 1957.

[Title of District Court and Cause.]

ANSWER OF DEFENDANTS THE ASHTON
COMPANY, INC., CONTRACTORS AND
ENGINEERS, formerly ASHTON BUILD-
ING COMPANY, and MARDIAN CON-
STRUCTION COMPANY, corporations en-
gaged in Joint Venture as ASHTON-MAR-
DIAN COMPANY

Comes now the defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in Joint Venture as Ashton-Mardian Company, and in answer to plaintiff's complaint filed herein, admit, deny and allege as follows:

I.

Admit the allegations contained in paragraphs I, II, III, IV and V of plaintiff's complaint.

II.

In answer to Paragraph VI of plaintiff's complaint, admit the allegations set forth in paragraph VI of plaintiff's complaint except the allegation that the plaintiff was not notified and had no knowledge as to the termination of said subcontract and as to those allegations, the defendants allege that they have no knowledge or information sufficient to form a belief as to the truth thereof and therefore deny the same.

III.

Admit the allegations set forth in paragraph VII of plaintiff's complaint except the allegation

that the plaintiff was without notice or knowledge of the contract referred to in said paragraph and as to those allegations, the defendants allege that they have no knowledge or information sufficient to form a belief as to the truth thereof and therefore deny the same.

IV.

In answer to paragraph VIII of plaintiff's complaint, admit that the work to be performed under the subcontract to the defendant Construction Materials Company was included in the prime subcontract with the defendant Pioneer Constructors, which work was not completed prior to the termination of the Pioneer Constructors' subcontract; deny that said subcontracts were one and the same and deny that the work called for in the Construction Materials Company's subcontract has been completed.

V.

In answer to paragraph IX and X of plaintiff's complaint, allege that they have no knowledge or information sufficient to form a belief as to the truth of the allegations contained in said paragraphs IX and X of the complaint and therefore deny the same.

VI.

In answer to paragraph XI of plaintiff's complaint, admit that the plaintiff did send written notice to these defendants of plaintiff's claim, as in said paragraph alleged. These defendants allege, however, that they have no knowledge or information sufficient to form a belief as to whether or not

said notice was received within ninety days from the date on which plaintiff furnished or supplied the last of the materials on which the claim is based and therefore denies this portion of paragraph XI.

VII.

In answer to paragraph XII of plaintiff's complaint, admit that the defendant Construction Materials Company and these defendants continued to perform the subcontract of the defendant Construction Materials Company and the prime contract of these defendants with the United States of America, but deny that performance thereof has been completed and admit that final settlement of said contract with the United States of America has not been made.

VIII.

Admit the allegations contained in paragraph XIII of plaintiff's complaint.

Wherefore, these defendants pray that plaintiff take nothing by its complaint and for their costs herein expended.

HALL, CATLIN & MOLLOY,

/s/ By HAMILTON R. CATLIN,

Attorneys for defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in Joint Venture as Ashton-Mardian Company.

Notice of Mailing Attached.

[Endorsed]: Filed June 21, 1957.

In The District Court of the United States
In and For The District of Arizona

No. Civ.—967 Tuc.

UNITED STATES OF AMERICA, for the Use
of APACHE POWDER COMPANY, a cor-
poration, Plaintiff,

vs.

THE ASHTON COMPANY, INC., CONTRAC-
TORS AND ENGINEERS, formerly ASH-
TON BUILDING COMPANY, and MAR-
DIAN CONSTRUCTION COMPANY, cor-
porations engaged in Joint Venture as ASH-
TON-MARDIAN COMPANY; THE TRAV-
ELERS INDEMNITY COMPANY, a cor-
poration; PIONEER CONSTRUCTORS, a
corporation; and CONSTRUCTION MATE-
RIALS COMPANY, a corporation,
Defendants.

THE ASHTON COMPANY, INC., CONTRAC-
TORS AND ENGINEERS, an Arizona Cor-
poration, and MARDIAN CONSTRUCTION
COMPANY, an Arizona Corporation, dba
ASHTON-MARDIAN COMPANY, a joint
venture, Third Party Plaintiffs,

vs.

HARTFORD ACCIDENT AND INDEMNITY
COMPANY, a corporation,
Third Party Defendant.

MOTION FOR MORE DEFINITE STATEMENT

Comes now the third party defendant, Hartford Accident and Indemnity Company, a corporation, and moves for a more definite statement of plaintiff's complaint in this, to-wit: that it furnish an account of the material alleged to have been furnished to Pioneer Constructors prior to November 1, 1956 and to defendant Construction Materials Company subsequent to said date for the reason that said materials, if any, were furnished under different contracts and under different bonds and that different defenses are available to this third party defendant in connection with materials furnished to defendant Pioneer Constructors than are available in connection with materials furnished to Construction Materials Company.

CONNER & JONES,

/s/ By A. O. JOHNSON,

Attorneys for Third Party
Defendant.

Memorandum of Points and Authorities

Rule 12 (e) provides for a more definite statement. It is respectfully submitted, that plaintiff's complaint in effect attempts to set up two separate causes of action, one against defendant Ashton-Mardian Company and defendant Pioneer Constructors and the other against Ashton-Mardian Company and Construction Materials Company, and third party defendant further submits that

different defenses are available on the two causes of action and therefore to properly plead the said complaint third party defendant should have this more definite statement.

CONNER & JONES,

/s/ By A. O. JOHNSON,

Attorneys for Third Party
Defendant.

Notice of Mailing Attached.

[Endorsed]: Filed July 10, 1957.

[Title of District Court and Cause.]

PLAINTIFF'S RESPONSE TO THIRD PARTY
DEFENDANT'S MOTION FOR MORE
DEFINITE STATEMENT

Comes Now the plaintiff, United States of America, for the use of Apache Powder Company, and, in response to the Motion for More Definite Statement, requesting an account of the materials furnished to defendant Pioneer Constructors prior to November 1, 1956, and to defendant Construction Materials Company subsequent to that date, filed herein by Hartford Accident and Indemnity Company, third party defendant, states as follows:

1. The materials furnished by Apache Powder Company prior to November 1, 1956, for use in the prosecution of the work under the prime contract with the United States of America, were furnished from and including June 13, 1956, to and including October 24, 1956, were of the agreed

and reasonable value of \$20,900.39, and were furnished to Pioneer Constructors.

2. The materials furnished by Apache Powder Company subsequent to November 1, 1956, for use in the prosecution of the work under the prime contract with the United States of America, were furnished from and including November 2, 1956, to and including March 12, 1957, were of the agreed and reasonable value of \$12,553.32, and were furnished to Pioneer Constructors and Construction Materials Company. Such materials were delivered to Construction Materials Company, but were invoiced to Pioneer Constructors, Apache Powder Company then being informed and believing that Construction Materials Company was a division of Pioneer Constructors, and believing and having reason to believe it was furnishing all of said material to Pioneer Constructors under the subcontract of March 30, 1956.

EVANS, KITCHEL & JENCKES,

/s/ By ALFRED B. CARR,

Attorneys for Plaintiff.

Notice of Mailing Attached.

[Endorsed]: Filed July 16, 1957.

[Title of District Court and Cause.]

ANSWER OF DEFENDANT PIONEER
CONSTRUCTORS, A CORPORATION

Comes now the defendant, Pioneer Constructors, a corporation, and in answer to plaintiff's com-

plaint filed herein, admits, denies and alleges as follows:

1. Incorporates herein by reference, the same as if they were set forth herein in full, paragraphs I through VIII of the pleading heretofore filed in the above entitled cause, entitled, "Answer of Defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in Joint Venture as Ashton-Mardian Company."

2. This defendant specifically alleges that the notice referred to in paragraph XI of plaintiff's complaint was not furnished and delivered by the plaintiff within 90 days from the date on which the last of any material was furnished and delivered to this defendant.

Wherefore, this defendant prays that plaintiff take nothing by its action or complaint and that the same should be dismissed against this defendant and that this defendant recover its costs herein expended.

FICKETT & DUNIPACE,

/s/ By FRED W. FICKETT,

Attorneys for Defendant Pioneer
Constructors, a Corporation.

Notice of Mailing Attached.

[Endorsed]: Filed July 18, 1957.

[Title of District Court and Cause.]

ANSWER OF THIRD PARTY DEFENDANT
TO PLAINTIFF'S COMPLAINT

Comes now the third party defendant, Hartford Accident and Indemnity Company, a corporation, and for its answer to plaintiff's complaint and to plaintiff's more definite statement thereon admits, denies and alleges as follows:

I.

Admits the allegations set forth in paragraphs I, II, III and V of said complaint;

II.

Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations set forth in paragraph IV of said complaint;

III.

Admits the allegations set forth in paragraph VI of said complaint except the allegations that the termination of the contract with Pioneer Constructors was without notice to or knowledge by plaintiff and in this connection on information and belief alleges that notice was given to plaintiff of said termination and that plaintiff had knowledge thereof;

IV.

Admits the allegations set forth in paragraph VII of said complaint except the allegation that the matters and things set forth therein were with-

out notice to or knowledge thereof by plaintiff and in this connection alleges on information and belief that plaintiff had notice and knowledge thereof;

V.

Denies the allegations set forth in paragraph VIII of said complaint;

VI.

In answer to the allegations set forth in paragraph IX of said complaint admits that plaintiff furnished materials to Pioneer Constructors and Construction Materials Company; alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegation as to the agreed and reasonable value of said materials; denies each and every allegation set forth in paragraph IX not herein specifically admitted;

VII.

In answer to the allegations set forth in paragraph X of said complaint this defendant alleges on information and belief that no sum is owing to plaintiff by defendant Construction Materials Company and alleges on information that defendant Construction Materials Company has paid plaintiff for all materials furnished to said defendant by plaintiff; alleges that it is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations set forth in said paragraph X;

VIII.

Denies the allegations set forth in paragraph

XI of said complaint and in this connection alleges that the subcontract of defendant Pioneer Constructors was terminated as of November 1, 1956, and from and after said date no work was done on said job on said subcontract nor were any materials purchased by or furnished to said Pioneer Constructors from and after the first day of November, 1956, and that no notice was given to the prime contractor on said job by plaintiff within ninety days from the date on which the last of the material was furnished by it to defendant Pioneer Constructors;

IX.

In answer to the allegations set forth in paragraph XII alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegation that performance thereof has been completed; admits the remaining allegations set forth in said paragraph.

X.

Admits the allegations set forth in paragraph XIII of said complaint;

XI.

Denies each and every allegation set forth in said complaint not specifically admitted herein;

XII.

Further answering, third party defendant alleges that complaint does not state a claim upon which relief can be granted.

XIII.

In answer to the allegations set forth in paragraph 1 of plaintiff's response to motion for more definite statement, third party defendant alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations set forth therein and therefore denies the same;

XIV.

In answer to the allegations set forth in paragraph 2 of said response, third party defendant admits that plaintiff furnished materials to defendant Construction Materials Company; alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegation as to the value of said materials; denies that any materials were furnished to defendant Pioneer Constructors subsequent to November 1, 1956; admits that said materials were delivered to said Construction Materials Company; denies each and every allegation set forth in said paragraph 2 not herein specifically admitted and further alleges on information and belief that Construction Materials Company has paid plaintiff for all materials furnished to said Construction Materials Company;

XV.

Denies each and every allegation set forth in said response not herein specifically admitted.

Wherefore, third party defendant prays that de-

defendant take nothing by its complaint and for its costs herein expended.

CONNER & JONES,

/s/ By A. O. JOHNSON,

Attorneys for Third Party
Defendant.

Notice of Mailing Attached.

[Endorsed]: Filed July 23, 1957.

[Title of District Court and Cause.]

ANSWER OF DEFENDANT THE TRAVEL-
ERS INDEMNITY COMPANY, A COR-
PORATION

Comes now the defendant The Travelers Indemnity Company, a corporation, and in answer to plaintiff's complaint filed herein, admits, denies and alleges as follows:

I.

Admits the allegations contained in paragraphs I, II, III, IV, and V of plaintiff's complaint.

II.

In answer to paragraph VI of plaintiff's complaint, admits the allegations set forth in paragraph VI of plaintiff's complaint except the allegation that the plaintiff was not notified and had no knowledge as to the termination of said subcontract and as to those allegations, this defendant alleges that it has no knowledge or information sufficient to form a belief as to the truth thereof and therefore denies the same.

III.

Admits the allegations set forth in paragraph VII of plaintiff's complaint except the allegation that the plaintiff was without notice or knowledge of the contract referred to in said paragraph and as to those allegations, this defendant alleges that it has no knowledge or information sufficient to form a belief as to the truth thereof and therefore denies the same.

IV.

In answer to paragraph VIII of plaintiff's complaint, admits that the work to be performed under the subcontract to the defendant Construction Materials Company was included in the subcontract with the defendant Pioneer Constructors, which work was not completed prior to the termination of the Pioneer Constructors' subcontract; denies that said subcontracts were one and the same and denies that the work called for in the Construction Materials Company's subcontract has been completed.

V.

In answer to paragraph IX and X of plaintiff's complaint alleges that it has no knowledge or information sufficient to form a belief as to the truth of the allegations contained in said paragraphs IX and X of the complaint and therefore denies the same.

VI.

In answer to paragraph XI of plaintiff's complaint, admit that the plaintiff did send written notice to the defendant The Ashton Company, Inc.,

Contractors and Engineers, and Mardian Construction Company, corporations engaged in a joint venture as Ashton-Mardian Company, as in said paragraph alleged. This defendant, however, alleges that it has no knowledge or information sufficient to form a belief as to whether or not said notice was received within ninety days from the date on which plaintiff furnished or supplied the last of the materials on which the claim is based and therefore denies this portion of paragraph XI.

VII.

In answer to paragraph XII of plaintiff's complaint, admits that the defendant Construction Materials Company and the defendant The Ashton Company, Inc., Contractors and Engineers, and Mardian Construction Company, corporations engaged in a joint venture as Ashton-Mardian Company, continued to perform the subcontract of the defendant Construction Materials Company and the prime contract of said defendant with the United States of America, but denies that the performance thereof has been completed and admits that final settlement of said contract with the United States of America has not been made.

VIII.

Admits the allegations contained in paragraph XIII of plaintiff's complaint.

Wherefore, this defendant prays that plaintiff

take nothing by its complaint and for its costs herein expended.

HALL, CATLIN & MOLLOY,
/s/ By HAMILTON R. CATLIN,
Attorneys for defendant The Travelers Indemnity Company.

Notice of Mailing Attached.

[Endorsed]: Filed August 1, 1957.

[Title of District Court and Cause.]

PRE-TRIAL CONFERENCE

The Above Entitled Matter came on regularly for hearing on the 30th day of January, 1958, before the Honorable James A. Walsh, Judge of the United States District Court, Federal Courthouse, Tucson, Arizona, commencing at the hour of 10:00 o'clock a.m. on said day and the following proceedings were had, to wit: [4]*

* * * * *

The Court: That is right.

What is the view of counsel as to this method of procedure to keep it a little more simple: If we separate for trial and try first the issues made by the complaints and answers to the complaints with the right of all who are parties to participate in that trial and to adduce evidence that bears on the issues made by the complaints and answers to the complaints.

* Page numbers appearing at top of page of Reporter's Transcript of Pre-Trial Conference.

What I am getting at, we have the question of release here; Mr. Johnson has it in one of his answers. We have the question of counterclaims and crossclaims and third party claims and all of those are subsidiary, of course, to there being recovery on the complaints. It seems to me that the logical way to approach it would be to try the case on the complaints and answers and then, depending on the judgment. [6] * * * * *

Mr. Johnson: It seems to me that is logical.

The Court: What is the thinking of counsel to confining the original trial to the issues made by the complaints and the answers?

Mr. Fickett: I think it is a very practical suggestion.

Mr. Catlin: Mr. Johnson would be interested in participating in that stage only.

The Court: I said that all parties would be entitled to participate and offer proof, because they all have a stake.

In other words, what we are doing actually is merely trying the case in stages and not cutting anybody out of a right that they would have had if we tried it all at once. What I am trying to do is avoid having to take up those things unless they really have to be decided.

Well, unless there is objection to the date set, we will proceed on that basis and try the issues made by the complaints and the answers to the complaints with the right of all parties to participate and to offer evidence within those issues.

Mr. Carr: Are both of these cases set on March 4?

The Court: They are not consolidated but they are set at the same time because we have common issues of fact, I am sure, and probably at law. [7]

* * * * *

The Court: In the Apache Powder case, as I got the issues from the pleadings, assuming there again there is no real issue as to whether materials were furnished by Apache Powder and as to the amounts paid for the materials, first, was there in fact and/or in law actually only one subcontract under which the use plaintiff furnished all of the material.

They take the position that this was all actually just one subcontract and that they furnished all of their material under one subcontract, and that actually is denied by the defendants.

The second issue, as I see it, would be if there was in fact and/or in law only one subcontract, were sufficient notices given within ninety days.

The third one would be if there was more than one subcontract, is there any estoppel against the prime contractor and the surety claiming that the use plaintiffs furnished materials under two distinct subcontracts and were required to give ninety days notice on material furnished under such subcontract; if, in fact, there were two subcontracts, [11] is there any estoppel against the prime and the surety to claim that there were two and that the notice was required on each.

The fourth issue that I see is, did the use plain-

tiffs have actual notice of the change of subcontractors.

The fifth would be, did the use plaintiffs furnish materials to Pioneer as Pioneer and to Construction as Construction, extending credit to the specific company to which the materials were furnished.

Sixth, were the use plaintiffs charged with notice that they were dealing with a new and different subcontractor after November 1, 1956, and if so, when did they become charged with that notice.

Those are the issues as I would frame them. Does anybody have any additional ideas?

Mr. Carr: I just have two questions here, your Honor, as to scope of evidence that might be introduced under each.

Under number one, is it understood that evidence may be introduced to the effect that the two subcontractors had the same offices, some of the same offices, employees; that the two subcontracts were performed under the same management, generally the same equipment and personnel and the use of the same supplies and the same suppliers.

It is my understanding of this question that that type of evidence would be admissible under that issue. I [12] just wanted to verify it.

The Court: I would say so, yes.

Mr. Johnson: I assume, your Honor, by making that ruling now is not precluding us from objecting to the admissibility of that evidence at the trial?

The Court: Oh, no.

Mr. Carr: Under two, if there was in fact and/or in law only one subcontractor, were suffi-

cient notices given within ninety days. I assume there is no dispute as to the delivery of the notice by Apache dated April 25th as alleged in the complaint? It would be a matter of a few moments to introduce it, but——

Mr. Catlin: Is that attached to the pleadings?

Mr. Carr: No, a copy isn't attached. The allegation was made. That is in paragraph eleven of the complaint.

Mr. Johnson: I might state at this time that only Ashton-Mardian and Apache knows how that notice was delivered, whether it was registered mail or by process. Now, whether it was actually served that way, I don't know.

The Court: The cases hold that regular mails are sufficient. The Supreme Court of the United States has so held. You can't get any higher than that. The Court says what the Statute is aiming at is to get the notice, and if regular mail was received, it doesn't have to be registered.

Mr. Carr: As a matter of fact, it was, your Honor. It was just a detail of evidence as to proof of the receipt [13] of the notice as of that date at that specific time, of course, saving the question as to whether the notice was filed within the time required.

You admit service of the notice as alleged, but do not state whether or not it was within ninety days.

Mr. Catlin: I thought that was the case.

Mr. Fickett: That admission answers your question, doesn't it, Mr. Carr?

Mr. Carr: Except that I don't believe it is uni-

form through the pleadings of all of the defendants.

The Court: Are any of the defendants or third party defendants going to go into the actual giving of the notice? In other words, are you in disagreement with Ashton-Mardian's admission?

Mr. Fickett: May I state that Pioneer agrees with Ashton-Mardian's admission.

Mr. Johnson: You say you sent this by registered mail? Do you have the registered receipt showing the date?

Mr. Carr: Yes.

Mr. Johnson: Do you have it with you now?

Mr. Carr: No, I don't.

Mr. Johnson: Well, whatever date that registered receipt shows, we will take that as the date.

I will state this: We will be bound by Ashton-Mardian's admission that notice was received. I don't think [14] they have alleged or admitted the date. That may be the material angle but we don't have the information on it.

Mr. Carr: In paragraph three reference is made as to estoppel.

The Court: The question is whether or not evidence would be admissible under that as to the reasons for the consideration for and the circumstances surrounding the termination of the Pioneer contract and the execution of the Construction Material's contract.

Mr. Carr: We have very little evidence as yet as a result of the depositions of Mr. Skorpick and Mr. Simmons, but there is some question, and in view of the Court's use of the word "estoppel" and sug-

gesting the question of estoppel here, we think that is material and might be necessary for us to go into that question.

The Court: I could only say in the absence of some specific matters, Mr. Carr, that anything that would bear on this issue, that I am not foreclosing objections to it again, but I am telling you that I would be inclined to hear anything that was relevant on the issue of estoppel.

Mr. Carr: And under four, "Did the use plaintiffs have actual notice of the change of subcontractors?", I assume under that, your Honor, that you include everything—that is for the benefit of the defendants as well as the plaintiffs—would include anything that might be considered as direct and [15] actual notice for something which might have and should have put the use plaintiffs on notice?

The Court: I had in mind the latter more nearly in six, even though they didn't have actual notice, were they in possession of such facts that they were charged with notice.

Mr. Carr: Just so those are included. Those are all of my questions. [16]

* * * * *

Mr. Thompson: Now Construction Materials isn't a defendant in the Armco case, however, I would like to ask counsel for them if they have a copy of this second subcontract that was executed.

Mr. Catlin: I think I can furnish you that.

Mr. Evans: I don't have an extra copy.

Mr. Thompson: Mr. Johnson, in regard to one

of your pleadings, you have stated that there was a release attached thereto. There was none attached to the copy received by Armco.

Mr. Johnson: We will furnish you one.

Mr. Thompson: There will be no question raised by the defendant or third party defendant as to whether or not the materials used in the subcontract or subcontracts were a part of the materials required and used under the prime contract?

Mr. Catlin: That is correct, no issue.

Mr. Johnson: No issue. [19]

Mr. Fickett: Pioneer agrees.

Mr. Thompson: I think that is all I have at this time.

Mr. Johnson: I would like to ask for one or two admissions from the plaintiffs if they will so admit.

I would like to ask if the plaintiff will admit and stipulate that there were separate subcontracts, that the Pioneer Constructor's subcontract terminated on or about the 1st day of November, 1956 and that the contract was thereupon entered into with Construction Materials by the prime contractor?

Mr. Carr: Are you referring to separate pieces of paper executed by different parties?

Mr. Johnson: I am referring to contracts executed by the parties.

Mr. Carr: Your question is too general, Mr. Johnson. I don't want to make any admissions on that particular fact. In fact, the pleadings of the complaint, I think, would answer your question, but I just feel that the question is too general.

Mr. Johnson: In that case, we will be prepared

to prove that point rather than asking for an admission on it.

One other question of Apache Powder, you are claiming some \$20,900 in your complaint. Is it not true that there was a later credit on that job which is not reflected in the [20] pleadings?

Mr. Carr: Yes, we are prepared to introduce and show the application on the account of a credit memo to Pioneer Constructors in the sum of \$1,952.72 given at the termination by Construction Materials of the work at which time we took back what they had on hand and gave them credit for that amount, but it was a credit to Pioneer Constructors on the Pioneer Constructors' contract. That reduces the claim to \$18,947.96.

Mr. Evans: The only thing that concerns me about that, I have here a letter addressed to Construction Materials Company from Apache Powder signed by Mr. Henderson talking about this material which was removed from the Ajo job.

Mr. Carr: Well, that is a different matter entirely.

Mr. Evans: Is that a different job?

Mr. Carr: Yes.

Mr. Johnson: I take it your question goes to the question of whether or not the plaintiff had a right to credit the construction materials they picked up on the Pioneer account, is that right?

Mr. Carr: Yes. Well, I was just stating the fact of what we did. We issued the credit memo to Pioneer on the Pioneer account.

Mr. Evans: Let me ask you this: Does your

company [21] have any account that it carries at the present time in the name of Construction Materials Company that covers any work done or any materials furnished on this job?

Mr. Carr: No, we have never had an account with Construction Materials.

Mr. Evans: And even today you do not have?

Mr. Carr: No.

Mr. Evans: Let me ask you another question: Is there any, or is it agreed, or could it be agreed that the value of the materials furnished by Apache for use on the job in question subsequent to November the 1st, 1956 was of the value of whatever it was?

Mr. Carr: Well, that statement is made in our more definite statement in response to, I guess—I have forgotten,—which somebody required us to make a more definite statement.

Mr. Johnson: That was our motion.

Mr. Carr: Oh, yes, as we specified in that more definite statement that certain materials were——

Mr. Evans: Well, would Apache stipulate that Apache was paid by Construction Materials Company that sum subsequent to November 1, 1956?

Mr. Carr: No, because again that question is too general. As a matter of fact, we have received some payment which you have already shown in the deposition of Simmons, but we are getting into such a broad area there and it is a matter [22] of detailed presentation that I would want preserved.

Mr. Evans: Well, I was just thinking about that because I can see how you might be able to say that

Pioneer and Construction Materials were one and the same company and therefore that Pioneer would be responsible for acts or stuff received by Construction Materials, but I don't see how you can turn the thing around.

Mr. Carr: Well, that is a question.

Mr. Evans: In other words, I don't see how you could hold Construction Materials responsible for merchandise or materials that were delivered on the account of Pioneer Constructors, that is why I asked you if you had any account for Construction Materials and I noticed that the various invoices that I have which represent this twelve thousand some odd dollar figure are all invoiced to Pioneer.

Mr. Carr: That's right. All the invoices were to Pioneer; there was never an account with Construction Materials. All payments were credited on Pioneer's account and the credit memo I just mentioned was credited to the Pioneer account.

Mr. Evans: Are you prepared to stipulate that the Apache Powder Company delivered the various materials for which the recovery is sought and extended credit upon the basis of the credit of Pioneer Constructors as opposed to Construction Materials Company? [23]

Mr. Carr: No, I wouldn't want to make that stipulation.

Mr. Evans: Well, I wonder how you could show any reliance upon the credit of Construction Materials Company if, as you say, that at no time Apache had an account with Construction Materials.

Mr. Carr: That is a very good question, but I prefer not to say.

The Court: Mr. Carr, in response to their motion for more definite statement, you state such materials were delivered to Construction Materials Company but were invoiced to Pioneer Constructors; Apache Powder Company then being informed and believes that Construction Materials was a division of Pioneer Constructors and believing and having reason to believe it was furnishing all of said material to Pioneer Constructors under the subcontract of March 30, 1956.

Mr. Carr: Yes. I assumed, your Honor, that counsel's question was on the basis of Construction Materials being a separate corporation and that is why I—it is a tricky question—not that it is intended to be—but I think that we could best work that out by presentation of evidence.

Mr. Evans: You see, our point is simply this: It is obvious from the pleadings themselves that they are separate corporations, they are sued as separate corporations. Pioneer Constructors, a corporation, Construction Materials [24] Company, same thing. Now I think from the depositions on file and from the answers to the interrogatories that it is clear that Apache Powder Company had been paid twelve thousand five hundred some odd dollars subsequent to November 1st, which is the, I believe the amount or the value of the materials that were furnished after November 1st, 1956 and I just can't get it through my thick head how Construction Materials Company can be responsible for anything

that happened before that and why it should have to come down here and go through a whole trial on the basis of the pleadings, the depositions and the invoices and everything and the checks that are attached to the deposition and so on. If Pioneer owes the money, then they have got a bond and Construction Materials, I guess, has the same bonding company, doesn't it?

Mr. Johnson: That's right, different bond but same company.

Mr. Evans: It is the same thing and I can see how Pioneer might be responsible for Construction Materials' shortcomings, but I can't see how it works the other way around.

Mr. Carr: But you want to claim credit on behalf of Construction Materials for moneys paid to Apache on invoices to Pioneer on an account with Pioneer.

Mr. Evans: Because Construction Materials admitted they used that material. [25]

The Court: Of course on pre-trial, Mr. Evans, you can't get around more than you can get together on, and taking your statement at face value, you have very seldom had it so good.

Are there any other stipulations?

Mr. Fickett: I would like to ask Mr. Carr this question: With reference to this \$12,533.02 you admit, Mr. Carr, don't you, that all of the payments for that total sum of money were paid by checks drawn by Construction Materials Company on a bank account of Construction Materials Company?

Mr. Carr: Yes. Yes, but it is a question of application that is important. [26]

* * * * *

Mr. Carr: If there is nothing further, I would offer in evidence the copy of the prime contract between the Government and Ashton Building Company and Mardian Construction Company with the payment bond certified by the general contractor's office.

The Court: Is counsel familiar with this? [27]

I am going to mark it on the back in pencil, "Apache 1" and circle it, and may it be stipulated that what I have so marked may be marked in evidence by the clerk on the trial?

Mr. Fickett: Yes.

Mr. Johnson: No objection.

Mr. Catlin: And we are willing to stipulate that the photostatic copies of the two subcontracts attached to the crossclaim of Ashton-Mardian are true copies and may be admitted.

Mr. Carr: Will you be able to supply copies for the record, Mr. Catlin?

Mr. Catlin: Yes.

The Court: I am going to mark these "JV-a" and "JV-b". And may it be stipulated that these I have so marked may be marked in evidence by the clerk on the trial?

Mr. Johnson: So stipulated.

The Court: That is in Civil 967.

Mr. Evans: Your Honor, I have four separate sets of papers here, all of which are statements from or invoiced from, or bills of lading, covering

the shipments made by Apache of materials used on this job, all shipments being subsequent to November 1, 1956 which I would like to offer.

Mr. Fickett: Pioneer has no objection.

Mr. Johnson: No objection.

Mr. Evans: We would also like the clerk to mark in [28] evidence on behalf of Construction Materials Company the checks of Construction Materials Company which are attached to the original deposition in the file of the case.

The Court: Let's take this one at a time, Mr. Evans.

Mr. Evans: Yes.

Mr. Carr: If the Court please, I am not familiar with these invoice numbers and I am not so familiar with them that I could check them from memory. I have no objection to the introduction of these documents by Construction Materials as being the reports of the transaction, but do not want to be bound by the detail as to the total number of invoices, the numbers and amounts and so forth, and I have a further reservation in this respect, that some of these invoices do not have attached copies of the bills of lading, others have copies of the bills of lading attached, which are not completed showing the receipt by Pioneer Constructors or Construction Materials. I notice that three or four of the bills of lading——

The Court: To shorten it up, counsel is submitting them and asking if it may be stipulated that the clerk may mark these in evidence in 967. If it could be stipulated, I will label them now and——

Mr. Carr: Oh, yes, as being their record without any admission as to completeness or accuracy or anything of that sort? [29]

The Court: They will be received as offered and, of course, they are the exhibit of Construction Materials Company and you wouldn't be bound by it unless there is some stipulation in here that I don't know about.

I will mark what we have been talking about as Construction's A, B, C and D, and the record may show the stipulation that the clerk will mark those in evidence on the trial.

Mr. Carr: May it be understood that Apache Powder may at the trial introduce its records of orders invoiced dissipating and other material relating to the account?

The Court: Well, unless you have them here, you will have to offer them on the trial.

Mr. Evans: And we would also like by stipulation for the Court to mark in evidence as an additional exhibit for Construction Materials Company the four checks, three checks of the Construction Materials Company, that are attached to the deposition of J. E. Skorpick and Melvin Simmons.

Mr. Carr: Okay.

The Court: Is that stipulation satisfactory?

Mr. Fickett: Yes.

Mr. Johnson: Is it also stipulated that these copies of the checks and the attachments thereto are copies of the original which were received by Apache Powder Company? They purport to be carbon copies. [30]

Mr. Carr: I believe they are, your Honor, but I just hesitate to say.

Mr. Johnson: In other words, we are in this position: the checks and then there is a copy which shows which invoices they are purporting to pay, a copy of the statement. Will counsel stipulate now to avoid our necessity of subpoenaing some of their organization that they did receive it? I am asking for that stipulation.

Mr. Carr: You have the cancelled checks and we have the voucher attached to the original, so I am certain, your Honor, that there will be no question about it, but I haven't actually checked Apache's records since that deposition was taken.

Mr. Johnson: Will counsel agree to notify me if he will not so stipulate to give me time to subpoena the original from the Apache organization? In other words, we think that Apache received the originals of those vouchers or those statements which are attached to the checks.

Mr. Carr: Yes, I will agree to notify you if that is the fact.

The Court: I will then mark these as Construction's E, F and G and the record will show the stipulation that they may be marked in evidence by the clerk on the trial.

Does anybody else have any exhibits? [31]

Mr. Catlin: Your Honor, is it clear in both of these cases—it just occurs to me—I think the pleadings make it clear that both of the Use Plaintiffs are suing in this action under the Miller Act and not as materialmen to a subcontractor. Is it clear

that neither of the plaintiffs are alleging a [35] direct relationship with the prime contractor, with my clients, the joint venture?

Mr. Thompson: As of this time, no. We may change our theory half way through the trial.

Mr. Catlin: Let me state that I know of no basis upon which they could, but I don't even know if it is necessary to clear that up or not.

The Court: I take it that it is agreed that as of now that there is no claim that they had a direct contractual relation with the joint venture?

Mr. Johnson: I will state at this time that I will file a motion to amend my complaint on the basis of this.

The Court: Is that all the progress we can make on exhibits, stipulations?

Mr. Thompson: If the Court please, as far as the subcontracts which have been introduced in Civil 967, I wonder if those could also be utilized as counsel desires in 966?

Mr. Fickett: That is agreeable as far as we are concerned.

Mr. Johnson: We will stipulate that any exhibits that are introduced in either case, the same stipulation may apply to either case as far as they are material.

Mr. Catlin: Yes. [36]

[Endorsed]: Filed February 19, 1958.

[Title of District Court and Cause.]

MINUTE ENTRY OF THURSDAY,
JANUARY 30, 1958

November 1957 Term (Tucson Division) at Tucson
Honorable James A. Walsh, United States District
Judge, Presiding.

This cause comes on regularly for pre-trial conference this day. Alfred B. Carr, Esq., appears for the plaintiff. Hamilton Catlin, Esq., appears for the defendants Travelers Indemnity Company and Ashton-Mardian Company. Richard Evans, Esq., is present for the defendant Construction Materials Company. Fred W. Fickett, Esq., appears for the defendant Pioneer Constructors, and A. O. Johnson, Esq., appears for the defendant Hartford Accident and Indemnity Company.

Court and counsel agree that the issues made by the complaints and answers should be tried on Tuesday, March 4, 1958, and that the issues made by the Third Party complaints and answers thereto, counterclaims and answers thereto, and cross-claims and answers thereto, should be reserved for later and separate trial and It Is So Ordered.

Court and counsel agree that the issues formed by complaints and answers are stated in a typewritten sheet marked "Issues framed on pre-trial, etc." attached to the Court's record of proceedings at pre-trial. Counsel enter into various stipulations of fact which are recorded by the reporter.

It is stipulated by all parties that the following documents, marked in pencil by the Court as indi-

ated, may be marked in evidence by the Clerk herein, viz: Apache 1, J VA and J VB, Construction A to Construction G, inclusive.

[Title of District Court and Cause.]

MINUTE ENTRY OF FRIDAY,

FEBRUARY 28, 1958

November 1957 Term (Tucson Division) at Tucson
Honorable James A. Walsh, United States District
Judge, Presiding.

Plaintiff's Motions for Leave to Amend Complaint and for Order Vacating Trial Setting come on regularly for hearing this day. Alfred B. Carr, Esq., is present for the plaintiff; Hamilton R. Catlin, Esq., is present for the defendants Travelers Indemnity Company and Ashton-Mardian Company; A. O. Johnson, Esq., is present for the Third Party Defendant Hartford Accident and Indemnity Company.

It Is Ordered that the plaintiff's Motion for Leave to File an Amended Complaint is granted, and

It Is Ordered that the Clerk is directed to file the plaintiff's Amended Complaint which is attached to said Motion.

It Is Ordered that the trial of the issues to be formed by the second count of the Amended Complaint and the answer thereto of the defendant Construction Materials Company be separated from the other issues and that the other issues will be tried as heretofore set on Tuesday, March 4, 1958, at 10 a.m.

[Title of District Court and Cause.]

AMENDED COMPLAINT

First Count

The United States of America, suing herein for the use and benefit of Apache Powder Company, a corporation, alleges:

I.

This action is brought under the Act of Congress of August 24, 1935, c. 642, § 2,49 Stat. 794, 40 U.S.C.A. § 270b, known as the Miller Act, on the payment bond of the contractor under a contract with the United States of America which was to be and was performed and executed within the District of Arizona.

II.

Apache Powder Company is a New Jersey corporation, authorized to do business in the State of Arizona. The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company are Arizona corporations engaged in a Joint Venture as Ashton-Mardian Company. The Travelers Indemnity Company is a Connecticut corporation, authorized to do business in the State of Arizona. Pioneer Constructors and Construction Materials Company are Arizona corporations.

III.

On or about March 30, 1956, the defendants, The Ashton Company, Inc., Contractors and Engineers,

as Ashton Building Company, and Mardian Construction Company, engaged in a Joint Venture as Ashton-Mardian Company, duly entered into a contract in writing with the United States of America, Corps of Engineers, United States Army, wherein and whereby it was agreed that said defendants were to furnish the material and perform the work for the construction and completion of Air Force Station TM-181, a radar station five miles North of Ajo, Pima County, State of Arizona, in accordance with plans and specifications and terms and conditions, therein specifically set forth, in consideration whereof the United States of America agreed to pay said defendants the sum of Two Million Three Hundred Fifty-one Thousand Six Hundred Thirty-seven and no/100ths Dollars (\$2,351,637.00).

IV.

On or about March 30, 1956, pursuant to the Act of Congress of August 24, 1935, c. 642, § 1,49 Stat. 793, 40 U.S.C.A. § 270a, and pursuant to the terms of the aforesaid contract, said Ashton-Mardian Company, a Joint Venture, as principal, and defendant, The Travelers Indemnity Company, as surety, for a valuable consideration, made, executed, and delivered to the United States of America their Payment Bond in the sum of Nine Hundred Forty Thousand Six Hundred Fifty-five and 04/100ths Dollars (\$940,655.04), the condition of which bond, as required by the said Act of Congress, is that the said principal shall promptly make payment to all persons supplying labor and

material in the prosecution of the work provided in said contract.

V.

On or about March 30, 1956, said Ashton-Mardian Company, a Joint Venture, as the prime contractor under said contract with the United States of America, entered into a subcontract with defendant, Pioneer Constructors, for the performance and completion of certain parts of the work, specified in said subcontract, which were to be performed and completed under said contract with the United States of America, in accordance with the plans and specifications and terms and conditions of said prime contract, in consideration whereof said prime contractor agreed to pay to said defendant Pioneer Constructors the sum of Four Hundred One Thousand Two Hundred Seventeen and 83/100ths Dollars (\$401,217.83).

VI.

Upon information and belief, the said Ashton-Mardian Company, as the prime contractor, and defendant, Pioneer Constructors, as a subcontractor, under said contract with the United States of America, entered upon the performance of said prime contract and subcontract and furnished labor and material therefor, but, without any notice to Apache Powder Company by any of the defendants and without any knowledge thereof by Apache Powder Company, said subcontract with defendant, Pioneer Constructors, was terminated on or about November 1, 1956.

VII.

That, without any notice to Apache Powder Company by any of the defendants and without any knowledge thereof by Apache Powder Company, on or about November 1, 1956, said Ashton-Mardian Company, a Joint Venture, as the prime contractor under said contract with the United States of America, entered into a subcontract with defendant Construction Materials Company for the performance and completion of certain parts of the work, specified in said subcontract, which were to be performed and completed under said contract with the United States of America, in accordance with the plans and specifications and terms and conditions of said prime contract, in consideration whereof said prime contractor agreed to pay to said defendant, Construction Materials Company, the sum of Two Hundred Sixty-six Thousand Three Hundred Ninety-one and 66/100 Dollars (\$266,391.66).

VIII.

Upon information and belief, the work to be performed under said subcontract of November 1, 1956, by defendant, Construction Materials Company, was identical with the work to be performed under said subcontract of March 30, 1956, by defendant, Pioneer Constructors, and said two subcontracts were in fact one and the same subcontract, part of which was performed and completed by defendant, Pioneer Constructors, and the remainder of which was performed and completed by defendant Construction Materials Company.

IX.

That from and including June 13, 1956, to and including October 31, 1956, on an open account at the special instance and request of defendant, Pioneer Constructors, Apache Powder Company furnished material consisting of explosives and blasting supplies to Pioneer Constructors for use in the prosecution of the work under its subcontract and said prime contract with the United States of America, of the agreed and reasonable value of Twenty Thousand Nine Hundred and 39/100ths Dollars (\$20,900.39), which material was delivered by Apache Powder Company on said radar station job and was used by Pioneer Constructors in the prosecution of the work under said subcontract and said prime contract with the United States of America.

That from and including November 1, 1956, to and including March 12, 1957, on said open account with Pioneer Constructors, at the special instance and request of Construction Materials Company, Apache Powder Company, being then informed by Construction Materials Company, and believing and having reason to believe, that Construction Materials Company was merely a division or agent of Pioneer Constructors, continued to furnish material consisting of explosives and blasting supplies to said radar station job for use in the prosecution of the work under the Pioneer Constructors subcontract of March 30, 1956, and said prime contract with the United States of America, which material was delivered by Apache Powder

Company on said radar station job and was used in the prosecution of the work required to be done under the Pioneer Constructors subcontract and said prime contract with the United States of America.

That the agreed and reasonable value of the materials furnished after November 1, 1956, is Twelve Thousand Five Hundred Fifty-three and 32/100ths Dollars (\$12,553.32), making the total of all materials furnished Thirty-three Thousand Four Hundred Fifty-three and 71/100ths Dollars (\$33,453.71).

X.

There remains due, owing, and unpaid to Apache Powder Company from Pioneer Constructors, after all payments and credits have been allowed, upon said material furnished, delivered, and used as aforesaid, the sum of Eighteen Thousand Nine Hundred Forty-seven and 96/100ths Dollars (\$18,947.96), no part of which sum has been paid, although payment thereof has been duly demanded.

XI.

The last of said material was furnished and delivered by Apache Powder Company on or about March 12, 1957, and, pursuant to the Act of Congress of August 24, 1935, c. 642, § 2, 49 Stat. 794, 40 U.S.C.A. § 270b, and within ninety (90) days from the date on which the last of said material was furnished and delivered, to-wit, on April 25, 1957, Apache Powder Company gave written notice to Ashton Building Company, Mardian Construc-

tion Company, and Ashton-Mardian Company, a Joint Venture, the prime contractor under said contract with the United States of America, stating with substantial accuracy the balance due and amount claimed by Apache Powder Company and the names of the parties to whom the material was furnished, which notice was served in the manner required by said Act of Congress.

XII.

Upon information and belief, defendant, Construction Materials Company and said Ashton-Mardian Company, continued to perform said subcontract and said prime contract with the United States of America, and performance thereof has been completed, but final settlement of said contract with the United States of America has not been made.

XIII.

That a period of ninety (90) days after the day on which the last of said material was furnished and delivered has expired, and that one (1) year after the date of final settlement of said contract with the United States of America has not expired.

Wherefore, the United States of America, on behalf and to the use of Apache Powder Company, prays judgment against defendants The Ashton Company, Inc., Contractors and Engineers, and Mardian Construction Company, corporations engaged in Joint Venture as Ashton-Mardian Company, The Travelers Indemnity Company, and Pio-

neer Constructors for the sum of Eighteen Thousand Nine Hundred Forty-seven and 96/100ths Dollars (\$18,947.96) with interest, for costs of suit herein incurred, and for such other and further relief as the Court may deem just and proper.

EVANS, KITCHEL & JENCKES,
/s/ By ALFRED B. CARR,
Attorneys for Plaintiff.

* * * * *

[Endorsed]: Filed February 28, 1958.

[Title of District Court and Causes.]

MINUTE ENTRY OF TUESDAY,
MARCH 4, 1958

November 1957 Term (Tucson Division) at Tucson.
Honorable James A. Walsh, United States District
Judge, Presiding.

This case comes on regularly for trial this day before the Court sitting without a jury. Howard Thompson, Esq., and John Elliott, Esq., appear as counsel for the plaintiff Armco Drainage & Metal Products, Inc. Alfred B. Carr, Esq., and Ralph Lester, Esq., appear as counsel for the plaintiff Apache Powder Company. Hamilton R. Catlin, Esq., appears as counsel for the defendants Ashton Company, Inc., Contractors and Engineers and Mardian Construction Company, dba Ashton- Mardian Company, and Travelers Indemnity Company. A. O. Johnson, Esq., appears as counsel for the Third Party Defendant, Hartford Acci-

dent and Indemnity Company. Fred W. Fickett, Esq., appears as counsel for the defendant Pioneer Constructors.

Both sides announce ready for trial.

It Is Ordered that the motion of the Third Party Defendant, Hartford Accident and Indemnity Company to amend its answer to the Complaint and Third Party Complaint is denied in case Civil-966 Tucson.

On motion of Howard Thompson, Esq., counsel for the plaintiff Armeo Drainage & Metal Products, Inc.,

It Is Ordered that the transcript of the pre-trial conference held herein on January 30, 1958, and filed herein on February 19, 1958, is incorporated as a part of the trial record in this cause. Counsel stipulate that the testimony of all the witnesses may be testimony in both cases Civil-966 Tucson and Civil-967 Tucson, where applicable.

Plaintiff Armeo Drainage & Metal Products, Inc.'s
Case:

Donald G. Putnam is sworn and examined on behalf of said plaintiff.

The following said plaintiff's exhibits are admitted in evidence:

- 1, carbon copy of list of sub-contractors
- 2, copy of letter

William Johnson is sworn and examined on behalf of said plaintiff.

Said plaintiff's exhibit 4, order form, is admitted in evidence.

Gerard John Sturm is sworn and examined on behalf of said plaintiff.

The following said plaintiff's exhibits are admitted in evidence:

5, letter

3, contract

Third Party Defendant Hartford Accident & Indemnity Company's exhibit A, copy of letter, is admitted in evidence.

Harold Ashton is sworn and cross-examined on behalf of said plaintiff.

The following said plaintiff's exhibits are admitted in evidence:

6, contract

7, contract

And thereupon, at 12:00 noon, It Is Ordered that the further trial of this case is continued to 1:30 P.M., this date, to which time counsel are excused.

Subsequently, at 1:30 P.M., all counsel being present pursuant to recess, further proceedings of trial are had as follows:

Plaintiff Armeo Drainage & Metal Products, Inc.'s Case Continued:

Counsel for the defendant Pioneer Constructors are given permission to withdraw from the Courtroom during the proceedings, the trial to continue in the absence of representation for said defendant.

Harold Ashton, heretofore sworn, is recalled and further cross-examined on behalf of said plaintiff.

Plaintiff Apache Powder Company's Exhibit 1, photostatic copy of letter, is admitted in evidence.

W. T. Melder is sworn and examined on behalf of the plaintiff Armco Drainage & Metal Products, Inc.

Said plaintiff's Exhibit 8, delivery receipt, is admitted in evidence.

Whereupon, the plaintiff Armco Drainage & Metal Products, Inc., rests.

Plaintiff Apache Powder Company's Case:

Melvin J. Simmons is sworn and examined on behalf of the plaintiff Apache Powder Company.

The following exhibits of the Third Party Defendant Hartford Accident and Indemnity Company are admitted in evidence:

B, Statement dated November 30, 1956, invoice, bills of lading

C, Statement dated December 31, 1956, invoices

D, Statement dated January 31, 1956, invoices, bills of lading

E, Statement dated March 31, 1957, invoices, bills of lading

F, Copy of check

G, Copy of check

H, Copy of check

I, Remittance dated February 12, 1957

J, Invoice dated December 10, 1956

K, Remittance copy, check copy, acknowledgments

Plaintiff Apache Powder Company's Exhibit 2, copy of letter and monthly statement, is admitted in evidence.

Robert Henderson is sworn and examined on behalf of the plaintiff Apache Powder Company.

Thereupon, at 4:40 P.M., It Is Ordered that the further trial of this case is continued to Wednesday, March 5, 1958, at 9:30 A.M., to which time all counsel are excused.

[Title of District Court and Causes.]

MINUTE ENTRY OF WEDNESDAY,
MARCH 5, 1958

November 1957 Term (Tucson Division) at Tucson.
Honorable James A. Walsh, United States District
Judge, Presiding.

All counsel being present pursuant to recess,
further proceedings of trial are had as follows:

Plaintiff Apache Powder Company's Case Continued:

Robert Henderson, heretofore sworn, is recalled and further examined on behalf of the plaintiff Apache Powder Company.

Said plaintiff's exhibits are admitted in evidence:

3, delivery orders

4, bills of lading

5, copies of statements to Pioneer Constructors

6, claim of Apache Powder Company

7A, receipt

7B, receipt

7C, receipt

8, credit memorandum

9, credit memorandum

10, envelope

11a, remittance slip

11b, remittance slip

11c, remittance slip and 5 invoices

The following exhibits of the defendant Ashton Company are admitted in evidence:

A, statement of account and letter of transmittal

B, copy of letter dated April 12, 1957

Paul Nagley is sworn and examined on behalf of the plaintiff Apache Powder Company.

And thereupon, at 12:00 noon, It Is Ordered that the further trial of this case is continued to 1:30 P.M., this date, to which time counsel are excused.

Subsequently, at 1:30 P.M., all counsel being present pursuant to recess, further proceedings of trial are had as follows:

Plaintiff Apache Powder Company's Case Continued:

Paul Nagley, heretofore sworn, is further examined on behalf of the plaintiff Apache Powder Company.

The following witnesses are sworn and examined on behalf of the plaintiff Apache Powder Company:

J. L. Smazal

Amos J. Browning

Whereupon, the plaintiff Apache Powder Company rests.

The plaintiff Apache Powder Company requests leave to amend the Amended Complaint, and

It Is Ordered that the plaintiff Apache Powder Company is granted leave to amend the Amended Complaint in respect to the date of the sub-contract with the defendant Construction Materials Company and the termination of the sub-contract of the defendant Pioneer Constructors; i.e., January 8, 1957.

Counsel for Hartford Accident and Indemnity Company moves on behalf of the Third Party Defendant for judgment against the plaintiffs Armco Drainage and Metal Products, Inc., and Apache Powder Company. Counsel for the defendant Ashton-Mardian Company joins in said motion.

The Court reserves its ruling on said motion.

Third Party Defendant Hartford Accident and Indemnity Company's case:

Paul Swaggerty is sworn and examined on behalf of the Third Party Defendant.

Whereupon, Third Party Defendant Hartford Accident and Indemnity Company rests.

Counsel for Hartford Accident and Indemnity Company renews Third Party Defendant's motion for judgment against the plaintiffs.

Counsel for the plaintiff Armco Drainage and Metal Products Company, Inc., moves for judgment on its complaint.

It Is Ordered that the motion for judgment against the defendant Pioneer Constructors, the prime contractor, and Travelers Indemnity Company is granted.

Counsel for the plaintiff Apache Powder Com-

pany moves for judgment on its complaint. The Court reserves ruling thereon.

The plaintiff Armco Drainage and Metal Products Company will prepare Findings of Fact, Conclusions of Law and Judgment.

[Title of District Court and Cause.]

MINUTE ENTRY OF THURSDAY,
MARCH 6, 1958

November 1957 Term (Tucson Division) at Tucson
Honorable James A. Walsh, United States District
Judge, Presiding.

The Court finds, *inter alia*, as follows:

Late in October, 1956, Pioneer and Construction Materials began negotiations between them looking to arrangements whereunder Construction Materials would replace Pioneer as the subcontractor on the Ajo job as of November 1, 1956.

In the last half of November, 1956, the prime contractor on the Ajo job agreed to terminate Pioneer's subcontract and to give Construction Materials a subcontract for all work remaining unperformed by Pioneer on November 1, 1956, provided that arrangements satisfactory to the prime contractor could be made for subcontractor bonding.

On January 8, 1957, the Pioneer subcontract was formally terminated and a new subcontract was entered into between the prime contractor and Construction Materials.

On December 4, 1956, in the expectation that the

termination of Pioneer's subcontract and the entry of Construction Materials into a subcontract would soon thereafter be formally accomplished, Construction Materials caused Apache to be notified that all materials thereafter supplied or delivered by Apache to the Ajo job were to be billed to Construction Materials.

That at the time such notice was given to Apache, Pioneer was indebted to Apache in the sum of approximately \$21,000.00 for materials supplied and delivered by Apache to the Ajo job prior to November 1, 1956.

That Apache ignored the notice given to it by Construction Materials and continued to bill Pioneer for the materials it furnished to the Ajo job after December 4, 1956, including in its statements Pioneer's unpaid balance as well as charges for materials ordered from Apache by Construction Materials after December 4, 1956.

That Pioneer's agents or employees delivered Apache's statements to Construction Materials and that Construction Materials paid Apache for the materials delivered by Apache to the Ajo job after November 1, 1956, but made no payment on the balance owing from Pioneer for materials delivered prior to November 1, 1956; that in making payments to Apache, Construction Materials used checks imprinted "Construction Materials Co., Construction Division"; that the vouchers accompanying Construction Materials check specified the numbers of the invoices for which the checks were tendered in payment and noted significantly that such

invoices had been "Billed to Pioneer" by Apache.

That after December 4, 1956, and not later than January 8, 1957, Apache had knowledge and information which would have lead a reasonably prudent person in the same situation to make an investigation of the subcontract situation on the Ajo job and the relationship of Pioneer and Construction Materials thereto; that if it had made such investigation, Apache would readily have learned not later than January 8, 1957, that all materials which it furnished to the Ajo job after December 4, 1956, had been ordered by Construction Materials, received by Construction Materials, and used by Construction Materials on the Ajo job and that Pioneer had not ordered, or received, or used any of the materials furnished by Apache since December 4, 1956; that Apache would have learned that Pioneer had, in fact, ceased to do any work on the Ajo job on October 31, 1956, and that all work done on the Ajo job thereafter had been done by Construction Materials. That Apache failed to make any reasonable effort, in the circumstances, to ascertain the facts regarding the subcontract situation and the relationship of Pioneer and Construction Materials thereto. That Apache did not act with ordinary prudence in protecting its rights as against the prime contractor and his surety.

That no written notice pursuant to 40 U.S.C., Section 270b(a) was given by Apache to the prime contractor until April 25, 1957, when Apache gave notice to the prime contractor by registered mail that it claimed a balance of \$20,900.69 for materials

furnished or supplied by it on the Ajo job to Pioneer Constructors and Construction Materials Company.

That all materials furnished or supplied by Apache to Construction Materials for use in the Ajo job were paid for by Construction Materials.

That the written notice required by 40 U.S.C., Section 270b(a) was not given by Apache to the prime contractor on the Ajo job within 90 days from the date on which Apache furnished or supplied the last of the materials to Pioneer.

That plaintiff is entitled to judgment on the first count of its amended complaint herein against defendant Pioneer for the sum of \$18,947.96, with interest at the rate of 6% per annum from November 1, 1956, until paid, and for plaintiff's costs of suit.

That defendants Ashton, Mardian, Ashton-Mardian Company, and Travelers are entitled to judgment against plaintiff on the first count of the amended complaint that plaintiff take nothing by said first count from said defendants, or any of them, and that said defendants have their costs of suit.

[Title of District Court and Cause.]

PROPOSED ADDITIONS TO FINDINGS OF FACT AND CONCLUSIONS OF LAW

Comes Now the plaintiff, United States of America, for the Use of Apache Powder Company, a corporation, and proposes the following

additions to the Findings of Fact and Conclusions of Law submitted herein by defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in Joint Venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, to-wit:

Findings of Fact

11(a). That the last of the material furnished by plaintiff Apache Powder Company on the aforesaid Ajo radar station job, prior to January 8, 1957, the date when the subcontract of defendant Pioneer Constructors was formally terminated and a new subcontract formally entered into between Ashton-Mardian Company and Construction Materials Company, was on December 20, 1956; and the last of the material furnished by plaintiff Apache Powder Company on the aforesaid Ajo job was furnished on March 12, 1957.

18(a). That on March 19, 1957, plaintiff Apache Powder Company gave oral notice to defendant Ashton-Mardian Company that plaintiff claimed a balance of \$25,312.60 for explosives and blasting supplies furnished by it prior to that date on the aforesaid Ajo radar station job to defendants Pioneer Constructors and Construction Materials Company.

Conclusions of Law

3(a). That the oral notice given by plaintiff Apache Powder Company to defendant Ashton-Mardian Company on March 19, 1957, was given

within ninety (90) days from the date on which plaintiff Apache Powder Company furnished the last of the materials to defendant Pioneer Constructors for which claim is made but did not comply with the requirements of Act of Congress of August 24, 1935, c. 642 Sec. 2, 49 Stat. 794, 40 U.S.C.A. Sec. 270(b).

EVANS, KITCHEL & JENCKES,
/s/ By ALFRED B. CARR,
Attorneys for Plaintiff.

Notice of Mailing Attached.

[Endorsed]: Lodged March 21, 1958.

[Title of District Court and Cause.]

OBJECTIONS TO PROPOSED ADDITIONS TO FINDINGS OF FACT AND CONCLUSIONS OF LAW

Come now the defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in joint venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, and third party defendant and object to the proposed additions to the findings of fact and conclusions of law submitted by the plaintiff for the following reasons:

I.

Object to proposed finding of fact 11(a) for the reason that said finding is immaterial as the evi-

dence shows that the new subcontractor Construction Materials Company was on the job on December 20, 1956, and that plaintiff had notice of said fact before said date, namely on December 4, 1956, and that any delivery of material subsequent to December 4, 1956, was necessarily made to Construction Materials Company.

II.

Object to proposed finding of fact 18(a) and conclusion of law 3(a) for the reason that said finding and conclusion are immaterial since oral notice does not comply with the Miller Act.

III.

Further object to conclusion of law 3 (a) for the reason that the oral notice on March 19, 1957, was not within 90 days from the date on which plaintiff furnished the last of the materials to defendant Pioneer Constructors which would necessarily have been prior to December 4, 1956.

HALL, CATLIN & JONES,

/s/ By HAMILTON R. CATLIN,

Attorneys for Defendants The Ashton Company, Inc., Mardian Construction Co., Ashton-Mardian Co., and The Travelers Indemnity Company.

CONNER & JONES,

/s/ By A. O. JOHNSON,

Attorneys for Hartford Accident and Indemnity Company.

Notice of Mailing Attached.

[Endorsed]: Filed March 20, 1958.

[Title of District Court and Cause.]

MINUTE ENTRY OF FRIDAY,
MARCH 21, 1958

November 1957 Term (Tucson Division) at Tucson.
Honorable James A. Walsh, United States District
Judge, Presiding.

The Court approves, settles, signs and files the Findings of Fact and Conclusions of Law proposed by the prime contractor and in addition the Court makes the following Findings of Fact and Conclusions of Law:

Findings of Fact

The last of the material furnished by plaintiff Apache Powder Company on the Ajo radar station job was furnished on March 12, 1957.

That on March 19, 1957, Apache Powder Company gave oral notice to defendant Ashton-Mardian Company that Apache claimed a balance of approximately \$25,000.00 for explosives and blasting supplies furnished by it prior to that date on the Ajo radar station job to defendant Pioneer Constructors.

Conclusion of Law

That the oral notice given by Apache Powder Company to defendant Ashton-Mardian Company on March 19, 1957, did not comply with the requirements of Act of Congress of August 24, 1935, c. 642 Sec. 2, 49 Stat. 794, 40 U.S.C.A. Sec. 270(b).

The Court signs and files the Judgment which is entered herein.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above entitled cause came on regularly for trial before the Court, sitting without a jury, on March 4, and 5, 1958, on the issues raised by the First Count of plaintiff's complaint and the answers thereto, and the Court having heard the testimony and having examined the proofs offered by the respective parties and the cause having been submitted to the Court for decision and the Court being fully advised in the premises now makes its Findings of Fact as follows:

Findings of Fact

1. This action was brought under the Act of Congress of August 24, 1935, c. 642, § 2, 49 Stat. 794, 40 U.S.C.A. § 270b.

2. Apache Powder Company is a New Jersey corporation, authorized to do business in the State of Arizona; The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, are Arizona corporations engaged in a joint venture as Ashton-Mardian Company; The Travelers Indemnity Company is a Connecticut corporation, authorized to do business in the State of Arizona; Pioneer Constructors is an Arizona corporation.

3. On or about March 30, 1956, the defendants, The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and

Mardian Construction Company, engaged in a joint venture as Ashton-Mardian Company, did enter into a contract in writing with the United States of America, Corps of Engineers, United States Army, wherein it was agreed that said defendants were to furnish the material and perform the work for the construction and completion of Air Force Station TM-181, a radar station five miles north of Ajo, Pima County, Arizona, in accordance with plans and specifications and terms and conditions therein specifically set forth.

4. On or about March 30, 1956, pursuant to Act of Congress of August 24, 1935, c. 642, § 2, 49 Stat. 794, 40 U.S.C.A. § 270a, and pursuant to the terms of the aforesaid contract, said defendant Ashton-Mardian Company, a joint venture, as principal and said defendant The Travelers Indemnity Company as surety, made, executed and delivered to the United States of America their payment bond as required by said Act of Congress.

5. On or about March 30, 1956, said defendants Ashton-Mardian Company, a joint venture, as prime contractor on said contract with the United States of America, entered into a subcontract with the defendant Pioneer Constructors, a corporation, for the performance and completion of certain parts of the work specified in said subcontract, which were to be performed and completed under said contract with the United States of America in accordance with the plans and specifications and terms and conditions of said prime contract.

6. That defendant Ashton-Mardian Company, as the prime contractor, and defendant Pioneer Constructors, as a subcontractor under said contract with the United States of America, entered upon the performance of said prime contract and subcontract and did furnish labor and materials therefor.

7. That the plaintiff Apache Powder Company did furnish materials to the subcontractor, Pioneer Constructors, from June 13, 1956, to and including the 31st day of October, 1956, at the special instance and request of the defendant Pioneer Constructors of a reasonable value of \$20,900.39.

8. That late in the month of October, 1956, Pioneer Constructors and Construction Materials Company, an Arizona corporation, began negotiations between themselves looking to arrangements whereunder Construction Materials Company would replace Pioneer Constructors as the subcontractor on the aforesaid job as of November 1, 1956.

9. That in the last half of November, 1956, defendant Ashton-Mardian Company agreed to terminate Pioneer Constructors' subcontract and to give Construction Materials Company a subcontract for all work remaining unperformed by Pioneer Constructors under its subcontract on November 1, 1956, provided that arrangements satisfactory to the defendant Ashton-Mardian Company could be made for subcontractor bonding.

10. That defendant Pioneer Constructors ceased the doing of any work on the aforesaid job on

October 31, 1956, and Construction Materials Company did perform all work encompassed under the Pioneer Constructors' subcontract done on and after November 1, 1956.

11. That on January 8, 1957, the subcontract of the defendant Pioneer Constructors was formally terminated and a new subcontract entered into between the defendant Ashton-Mardian Company, as prime contractor, and Construction Materials Company, as subcontractor, which subcontract encompassed all work under Pioneer Constructors' subcontract not completed on November 1, 1956.

12. On December 4, 1956, in the expectation that the defendant Pioneer Constructors' subcontract and the entry of Construction Materials Company into a subcontract would soon thereafter be formally accomplished, Construction Materials Company caused the plaintiff Apache Powder Company to be notified that all materials thereafter supplied or delivered by plaintiff Apache Powder Company to the aforesaid job were to be billed to Construction Materials Company.

13. That at the time such notice was given to plaintiff Apache Powder Company, defendant Pioneer Constructors was indebted to plaintiff Apache Powder Company in the sum of \$20,900.39, for materials supplied and delivered by plaintiff Apache Powder Company to the aforesaid job prior to November 1, 1956.

14. That plaintiff Apache Powder Company ignored the notice given to it by Construction Mate-

rials Company and continued to bill defendant Pioneer Constructors for the material furnished to the aforesaid job after December 4, 1956, including in its statement Pioneer Constructors' unpaid balance, as well as charges for materials ordered from plaintiff Apache Powder Company by Construction Materials Company after December 4, 1956.

15. That thereafter defendant Pioneer Constructors' agents or employees delivered plaintiff Apache Powder Company's statements to Construction Materials Company and that Construction Materials Company paid plaintiff Apache Powder Company for the materials delivered by plaintiff Apache Powder Company to the aforesaid job after November 1, 1956, but made no payment on the balance owing from Pioneer Constructors for materials delivered prior to November 1, 1956; that in making payments to plaintiff Apache Powder Company, Construction Materials Company used checks imprinted "Construction Materials Company, Construction Division"; that the vouchers accompanying Construction Materials Company's checks specified the numbers of the invoices for which the checks were tendered in payment and noted thereon that such invoices had been "billed to Pioneer" Constructors by Apache Powder Company.

16. That after December 4, 1956, and not later than January 8, 1957, plaintiff Apache Powder Company had knowledge and information which would have led a reasonably prudent person in the

same situation to make an investigation of the subcontract situation on the aforesaid job and the relationship of Pioneer Constructors and Construction Materials Company thereto; that if it had made such investigation, plaintiff Apache Powder Company would readily have learned not later than January 8, 1957, that all materials which it furnished to the aforesaid job after December 4, 1956, had been ordered by Construction Materials Company, received by Construction Materials Company, and used by Construction Materials Company on the aforesaid job and that defendant Pioneer Constructors had not ordered or received or used any of the materials furnished by plaintiff Apache Powder Company since December 4, 1956; that plaintiff Apache Powder Company would have learned that defendant Pioneer Constructors had in fact ceased to do any work on the aforesaid job on October 31, 1956, and that all work done on the aforesaid job thereafter had been done by Construction Materials Company.

17. That plaintiff Apache Powder Company failed to make any reasonable effort under the circumstances to ascertain the facts regarding the subcontract situation and the relationship of Pioneer Constructors and Construction Materials Company thereto; that plaintiff Apache Powder Company did not act with ordinary prudence in protecting its rights as against the prime contractor and its surety.

18. That no written notice pursuant to Act of

Congress of August 24, 1935, c. 642 § 2, 49 Stat. 794, 40 U.S.C.A. § 270b(a) was given by plaintiff Apache Powder Company to the defendant Ashton-Mardian Company until April 25, 1957, when plaintiff Apache Powder Company gave notice to defendant Ashton-Mardian Company, by registered mail, that it claimed a balance of \$20,900.39 for materials furnished or supplied by it on the aforesaid job to Pioneer Constructors and Construction Materials Company.

19. That all materials furnished or supplied by plaintiff Apache Powder Company to Construction Materials Company for use on the aforesaid job were paid for by Construction Materials Company.

20. That there remains due and owing from the defendant Pioneer Constructors to plaintiff Apache Powder Company after the allowance of all credits and offsets the sum of \$18,947.96, with interest at the rate of six per cent per annum from November 1, 1956, until paid.

From the foregoing facts the Court concludes:

Conclusions of Law

1. That the Court has jurisdiction over the foregoing action and all parties thereto.

2. That plaintiff Apache Powder Company, a corporation, had direct contractual relationship with the defendant Pioneer Constructors, a corporation, but did not have any contractual relationship, either express or implied, with the defendant Ashton-Mardian Company, a joint ven-

ture composed of The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, a corporation, and Mardian Construction Company, a corporation.

3. That the written notice given by the plaintiff Apache Powder Company to the defendant Ashton-Mardian Company on April 25, 1957, was not given by said plaintiff to said defendant within ninety days from the date on which the plaintiff Apache Powder Company furnished and supplied the last of the materials to defendant Pioneer Constructors for which claim is made and thus did not comply with the requirements of Act of Congress of August 24, 1935, c. 642, § 2, 49 Stat. 794, 40 U.S.C.A. § 270b(a).

4. That the plaintiff Apache Powder Company is entitled to judgment against the defendant Pioneer Constructors on the First Count of its Amended Complaint for the sum of \$18,947.96, with interest at the rate of six per cent per annum from November 1, 1956, until paid and for its costs of suit.

5. That the plaintiff Apache Powder Company is not entitled to judgment against the defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, a corporation, and Mardian Construction Company, a corporation, Ashton-Mardian Company, a joint venture, and The Travelers Indemnity Company, a corporation, or any of them under the First Count of its Amended Complaint, and that said

defendants are entitled to judgment against the plaintiff for their costs of suit.

Let judgment be entered accordingly.

Dated this 21st day of March, 1958.

/s/ JAMES A. WALSH,
Judge of the District Court.

Notice of Mailing Attached.

[Endorsed]: Filed March 21, 1958.

In The District Court of the United States
In and For The District of Arizona

No. Civ.—967 Tuc.

UNITED STATES OF AMERICA, for the Use
of APACHE POWDER COMPANY, a corporation,
Plaintiff,

vs.

THE ASHTON COMPANY, INC., CONTRACTORS AND ENGINEERS, formerly ASHTON BUILDING COMPANY, and MARDIAN CONSTRUCTION COMPANY, corporations engaged in Joint Venture as ASHTON-MARDIAN COMPANY; THE TRAVELERS INDEMNITY COMPANY, a corporation; PIONEER CONSTRUCTORS, a corporation; and CONSTRUCTION MATERIALS COMPANY, a corporation,

Defendants.

THE ASHTON COMPANY, INC., CONTRACTORS AND ENGINEERS, an Arizona corporation, and MARDIAN CONSTRUCTION COMPANY, an Arizona corporation, dba ASHTON-MARDIAN COMPANY, a joint venture,
Third Party Plaintiffs,

vs.

HARTFORD ACCIDENT AND INDEMNITY COMPANY, a corporation,
Third Party Defendant.

JUDGMENT

This cause came on regularly for trial before the Court, sitting without a jury, on March 4 and 5, 1958, on the issues raised by the First Count of Plaintiff's Complaint and the answers thereto, and the Court having heard the testimony and having examined the proofs offered by the respective parties, and the Court being fully advised in the premises and having filed herein its Findings of Fact and Conclusions of Law and having directed that judgment be entered in accordance therewith; now, therefore, by reason of the law and the findings aforesaid:

It Is Ordered, Adjudged and Decreed:

1. That the plaintiff Apache Powder Company, a corporation, have judgment on the First Count of its Amended Complaint herein against defendant Pioneer Constructors, a corporation, for the sum of \$18,947.96, with interest at the rate of six

per cent per annum from November 1, 1956, until paid and for its costs of suit.

2. That defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in Joint Venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, have judgment against the plaintiff on the First Count of plaintiff's Amended Complaint; that plaintiff take nothing by said First Count from said defendants or any of them and that said defendants have their costs of suit.

Done In Open Court this 21st day of March, 1958.

/s/ JAMES A. WALSH,
Judge of the District Court.

[Endorsed]: Filed March 21, 1958.

[Title of District Court and Cause.]

CIVIL DOCKET ENTRY

* * * * *

1958

Mar. 21—38. Enter and file judgment lodged with the Court on Mar. 13, 1958, in favor of pltf. United States of America, for the Use of Apache Powder Company, a corporation, on the First Count of its Amended Complaint and against deft. Pioneer Constructors, a corp., in the sum

1958

Mar. 21 of \$18,947.96 with 6% int. per annum
(Cont.) from Nov. 1, 1956, until paid and for its costs of suit; in favor of defts. The Ashton Company, Inc., Contractors and Engineers, and Mardian Construction Company, dba Ashton-Mardian Company, a joint venture, and The Travelers Indemnity Company, a corp., against the pltf., United States of America, for the Use of Apache Powder Company, a corp., on the First Count of Pltf's Amended Complaint; that pltf. take nothing by said First Count from said defts. or any of them and that said defts. have their costs of suit. (Docketed 3/24/58.)

[Title of District Court and Cause.]

MINUTE ENTRY OF THURSDAY,
APRIL 3, 1958

November 1957 Term (Tucson Division) at Tucson.
Honorable James A. Walsh, United States District
Judge, Presiding.

Pursuant to the provisions of Rule 54(b), Federal Rules of Civil Procedure, the Court determines that there is no just reason for delay in entering judgment upon the claim made by the First Count of plaintiff's amended complaint. Accordingly, the Clerk is directed, pursuant to Rule 54(b), to forthwith enter judgment that the use plaintiff

have judgment on the First Count of its amended complaint against defendant Pioneer Constructors for the sum of \$18,947.96 with interest at 6% per annum from November 1, 1956, until paid and for costs; and further judgment that defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in Joint Venture as Ashton-Mardian Company, and the Travelers Indemnity Company, a corporation, have judgment against the plaintiff on the First Count of plaintiff's Amended Complaint, that plaintiff take nothing by said First Count from said defendants or any of them and that said defendants have their costs of suit.

[Title of District Court and Cause.]

CIVIL DOCKET ENTRY

Date 1958

* * * * *

Apr. 3—Enter judgment in favor of pltf. USA ex rel Apache Powder Company, a corp. on the First Count of its amended complaint against deft. Pioneer Constructors for the sum of \$18,947.96 with int. at 6% per annum from Nov. 1, 1956 until paid and for costs; and ent. fur. judgment in favor of defts. The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corpora-

1958

Apr. 3 tions engaged in Joint Venture as Ash-
(Cont.) ton-Mardian Company, and The Travel-
ers Indemnity Company, a corp. against
ptlf. USA ex rel Apache Powder Com-
pany on First Count of ptlf's Amended
Complaint, that ptlf. take nothing by said
First Count from said defts. or any of
them and that said defts. have their costs
of suit.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Apache Powder Company, a corporation, the use plaintiff above named, hereby appeals to the Circuit Court of Appeals of the United States for the Ninth Circuit from that part of the final judgment entered herein on the 24th day of March, 1958, against Apache Powder Company, a corporation, the use plaintiff herein, and in favor of The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in a Joint Venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, defendants herein.

EVANS, KITCHEL & JENCKES,
/s/ By ALFRED B. CARR,
Attorneys for Plaintiff.

[Endorsed]: Filed April 16, 1958.

[Title of District Court and Cause.]

BOND FOR COSTS ON APPEAL

Know All Men By These Presents:

That we, Apache Powder Company, a New Jersey corporation, authorized to do business in the State of Arizona, as Principal, and Fidelity and Deposit Company of Maryland, a corporation duly incorporated under the laws of the State of Maryland, of Baltimore, Maryland, having an office and usual place of business at Phoenix, Arizona, as Surety, are held and firmly bound unto The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in a Joint Venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, in the sum of Two Hundred Fifty Dollars (\$250.-00), lawful money of the United States of America, to be paid to the said Ashton-Mardian Company and The Travelers Indemnity Company, their successors or assigns, for which payment well and truly to be made and done we bind ourselves, our successors and assigns, jointly and severally by these presents.

Sealed with our seals and dated this 15th day of April, 1958.

Whereas, the aforesaid Principal is filing notice of appeal to the Circuit Court of Appeals of the United States for the Ninth Circuit from that part of the judgment of the District Court of the United States for the Tucson Division of the

Judicial District of Arizona, entered on the 24th day of March, 1958, against the said Principal and in favor of said Ashton-Mardian Company and The Travelers Indemnity Company in the above-entitled action.

Now The Condition of This Obligation Is Such, That if the said Appellant shall pay the costs if the appeal is dismissed or the judgment is affirmed or such costs as the Appellant Court may award if the judgment is modified, then this obligation to be void; otherwise to remain in full force and virtue.

APACHE POWDER COMPANY,

/s/ By ALFRED B. CARR,

Its Attorney.

[Seal] FIDELITY AND DEPOSIT COM-
PANY OF MARYLAND,

/s/ By (Illegible),

Attorney-in-Fact.

[Endorsed]: Filed April 16, 1958.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Apache Powder Company, a corporation, the use plaintiff above named, hereby appeals to the Circuit Court of Appeals of the United States for the Ninth Circuit from that part of the preliminary judgment entered herein on the 24th day of March, 1958, and from that part of the final judgment entered herein on the 3rd day of April, 1958, against Apache Powder Company, a corporation, the use plaintiff

herein, and in favor of The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in a Joint Venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, defendants herein.

EVANS, KITCHEL & JENCKES,

/s/ By ALFRED B. CARR,
Attorneys for Plaintiff.

[Endorsed]: Filed April 28, 1958.

[Title of District Court and Cause.]

BOND FOR COSTS ON APPEAL

Know All Men By These Presents:

That we, Apache Powder Company, a New Jersey corporation, authorized to do business in the State of Arizona, as Principal, and Fidelity and Deposit Company of Maryland, a corporation duly incorporated under the laws of the State of Maryland, of Baltimore, Maryland, having an office and usual place of business at Phoenix, Arizona, as Surety, are held and firmly bound unto The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in a Joint Venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, in the sum of Two Hundred Fifty Dollars (\$250.-00), lawful money of the United States of America, to be paid to the said Ashton-Mardian Company and The Travelers Indemnity Company, their

successors or assigns, for which payment well and truly to be made and done we bind ourselves, our successors and assigns, jointly and severally by these presents.

Sealed with our seals and dated this 25th day of April, 1958.

Whereas, the aforesaid Principal is filing notice of appeal to the Circuit Court of Appeals of the United States for the Ninth Circuit from that part of the preliminary judgment of the District Court of the United States for the Tucson Division of the Judicial District of Arizona, entered on the 24th day of March, 1958, and from that part of the final judgment of said District Court entered herein on the 3rd day of April, 1958, against the said Principal and in favor of said Ashton-Mardian Company and The Travelers Indemnity Company in the above entitled action.

Now The Condition of This Obligation Is Such, That if the said Appellant shall pay the costs if the appeal is dismissed or the judgment is affirmed or such costs as the Appellate Court may award if the judgment is modified, then this obligation to be void; otherwise to remain in full force and virtue.

APACHE POWDER COMPANY,

/s/ By ALFRED B. CARR,

Its Attorney.

[Seal] FIDELITY AND DEPOSIT COMPANY OF MARYLAND,

/s/ By RALPH A. CASH,

Attorney-in-Fact.

[Endorsed]: Filed April 28, 1958.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,
District of Arizona—ss.

I, William H. Loveless, Clerk of the United States District Court for the District of Arizona, do hereby certify that I am the custodian of the records of the said Court, including the records in the case of United States of America, for the Use of Apache Powder Company, a corporation, Plaintiff, versus The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, et al., Defendants, numbered Civ. 967 Tucson, on the docket of said Court.

I further certify that the attached and foregoing original documents bearing the endorsements of filing thereon are the original documents filed in said case, and that the attached and foregoing copies of the minute and civil docket entries are true and correct copies of the originals thereof remaining in my office in the city of Tucson, State and District aforesaid.

I further certify that the said original documents, and said copies of the minute and docket entries, together with the original exhibits transmitted herewith, constitute the record on appeal in said case as designated in the Appellant's Designation filed therein and made a part of the record attached hereto and the same are as follows, to-wit:

1. Complaint

2. Answer of Defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in Joint Venture as Ashton-Mardian Company

3. Motion for More Definite Statement by third party defendant, Hartford Accident and Indemnity Company

4. Plaintiff's Response to Third Party Defendant's Motion for More Definite Statement

5. Answer of Defendant, Pioneer Constructors, a corporation

6. Answer of Third Party Defendant to Plaintiff's Complaint

7. Answer of Defendant, The Travelers Indemnity Company, a corporation

8. Transcript of Pre-trial Conference

9. Minute entry of January 30, 1958 (pre-trial conference)

10. Minute entry of February 28, 1958 (order granting leave to file amended complaint and for separate trials)

11. Amended complaint

12. Minute entry of March 4, 1958 (proceedings of trial)

13. Minute entry of March 5, 1958 (further proceedings of trial)

14. Minute entry of March 6, 1958 (decision)

15. Proposed Additions to Findings of Fact and Conclusions of Law

16. Objections to Proposed Additions to Findings of Fact and Conclusions of Law filed by de-

endants Ashton-Mardian Company and the Travelers Indemnity Company.

17. Minute entry of March 21, 1958 (settling findings of fact and conclusions of law and making additional findings of fact and conclusions of law)

18. Findings of Fact and Conclusions of Law

19. Judgment

20. Civil Docket Entry of Judgment of March 21, 1958

21. Civil Docket Entry of Judgment of April 3, 1958

22. Minute entry of April 3, 1958 for entry of judgment upon claim made by First Count of Amended Complaint

23. Notice of Appeal to Court of Appeals from judgment entered March 24, 1958

24. Plaintiff's Bond for Costs on Appeal relating to appeal from judgment entered March 24, 1958

25. Plaintiff's Notice of Appeal to Court of Appeals from preliminary judgment entered March 24, 1958, and final judgment entered April 3, 1958

26. Plaintiff's Bond for Costs on Appeal relating to appeal from preliminary judgment entered March 24, 1958 and final judgment entered April 3, 1958

27. Transcript of Proceedings

28. Designation of Contents of Record on Appeal.

I further certify that all original exhibits in evidence, or marked for identification, as desig-

nated by the appellant, are transmitted herewith as a part of this record on appeal, to-wit:

Plaintiff's exhibits 1, 2, 3, 4, 5, 6, 7A, 7B, 7C, 8, 9, 10, 11A, 11B and 11C in evidence.

Third Party Defendant's Exhibits A, B, C, D, E, F, G, H, I, J and K in evidence.

Defendant Ashton's exhibits A and B in evidence.

I further certify that the Clerk's fee for preparing and certifying this record on appeal amounts to the sum of \$5.20, and that said sum has been paid by counsel for the appellant.

Witness my hand and the seal of said Court this 16th day of June, 1958.

[Seal] WM. H. LOVELESS,
Clerk,

/s/ By CATHERINE A. DOUGHERTY,
Chief Deputy.

[Title of District Court and Causes.]

TRANSCRIPT OF PROCEEDINGS

Appearances: Messrs. McRae, Elliott & Thompson, by Mr. John L. Elliott, and Mr. Howard Thompson, for Plaintiff Armeo Drainage & Metal Products. Messrs. Evans, Hill, Kitchel & Jenckes, by Mr. Alfred B. Carr, and Mr. Ralph Lester, for Plaintiff Apache Powder Company. Messrs Fickett & Dunipace, by Mr. Fred W. Fickett, for Pioneer Constructors. Messrs. Hall, Catlin & Jones, by Mr. Hamilton R. Catlin, for Third Party De-

fendant Ashton-Mardian Company. Messrs. Boyle, Bilby, Thompson & Shoenhair, by Mr. Wilbert E. Dolph, Jr., for Construction Materials Company. Messrs. Conner & Jones, by Mr. A. O. Johnson, for Third Party Defendant, Hartford Accident & Indemnity Company.

The Above Entitled Matter came up for trial on the 4th day of March, 1958, at the hour of 10:00 o'clock A.M. at Tucson, Arizona, before the Honorable James A. Walsh, Judge, and the following proceedings were had, to-wit: [5]*

(The cases were called by the Clerk.)

The Court: Are the parties all ready?

(All parties indicating ready for trial.)

Mr. Johnson: We are ready, your Honor. Before proceeding for trial, we filed a motion to amend our answer, which is noticed for hearing next Monday, I believe. I think it should be ruled on now.

The Court: I will pass on it when I see what the evidence is. The reference that you make to the deposition in your motion, I don't believe that would support an amendment, if that is all you are basing it on.

Mr. Johnson: That is the question, your Honor.

The Court: The motion for leave to amend the answer, if that is the basis of it, what is referred to in the answers to the interrogatories?

Mr. Johnson: The answers to the interrogatories and also some similar information came out

* Page numbers appearing at top of page of Reporter's Transcript of Record.

in the deposition, and the evidence will also show it.

The Court: As I interpret that, it was something that happened after the materials had been furnished.

Mr. Johnson: That is right, your Honor.

The Court: The motion of the third party defendant to amend its answer in 966, the answer to complaint in 966 and the answer to the third party complaint in 966, is denied.

Mr. Dolph: Your Honor, I am appearing here on behalf [6] of Construction Materials Company, which is apparently not involved in the first count of the amended complaint in Case No. 967, and is not involved at all in the other case to go to trial today. We want to make sure the record was clear on our understanding that the second count of the amended complaint in which our client is involved is not to go to trial now and we will not be bound by the evidence in the trial of the other issues that are to be tried at this time.

The Court: That is correct. The issues made by the second count in 967 and the answer that may be filed thereto will be tried separately.

Mr. Dolph: Thank you, your Honor.

The Court: You may proceed, Mr. Thompson.

Mr. Thompson: If the Court please, prior to calling our first witness, I believe the Court is well aware of the fact that a pre-trial conference was held in this matter. As I understand it, the record of that pre-trial conference has been filed and is now a part of the record. I don't know whether

it requires a motion or not, but if it does I would like to move the Court to consider that pre-trial conference and the stipulations made therein as a part of this trial record.

The Court: Any objection to that?

Mr. Johnson: No objection.

Mr. Catlin: No objection. [7]

Mr. Carr: No objection.

The Court: The record may show the record of the pre-trial conference held in these cases on January 30th, 1958, which record was filed in this cause on February 19, 1958, is incorporated as a part of the record of this trial.

Mr. Thompson: Thank you, your Honor. One other item in that regard. During the pre-trial conference counsel for Armco Drainage & Metal Products Company asked for stipulation of the other counsel on the materials which were delivered on the job on December 13th, 1956. Mr. Johnson, representing Hartford, said that he would verify whether or not those materials were actually used on the job, and he advised me and the other counsel advised me at that time that they would so stipulate as to the Armco materials actually being used on the job, unless they notified me prior to trial; and I will avow to the Court at this time that no notice was given to me of those materials not being used on the job, so I am assuming then it is stipulated that the Armco materials were actually used on the job in question.

Mr. Johnson: Our information is to that effect, your Honor.

Mr. Thompson: I will call Mr. D. G. Putnam.

D. G. PUTNAM

called as a witness herein, having been first duly sworn, [8] testified as follows:

Direct Examination

Q. (By Mr. Thompson): Mr. Putnam, for the record, will you state your name, please?

A. Donald G. Putnam.

Q. Mr. Putnam, what is your occupation?

A. I am a civil engineer for the Corps of Engineers.

Q. Calling your attention to the early part of 1956, were you the project engineer on the United States Army Air Force Project TM-181 at Ajo, Arizona for the Corps of Engineers?

A. Yes, sir.

Q. In your capacity as the project engineer for the United States Corps of Engineers, do you officially deal with the prime contractor or the subcontractors on the job?

A. The prime contractor.

Q. In that regard is there any requirement requiring the prime contractor to furnish you a list of its subcontractors on the job?

A. There is a section of the contract specifications entitled General Conditions that require the submission of subcontractors' names upon request.

Q. Was that in the prime contract in this particular job?

Mr. Catlin: If it will help, we will stipulate that [9] provision is in the general contract, rather than have you go through it.

(Testimony of D. G. Putnam.)

Mr. Thompson: All right.

Q. (By Mr. Thompson): Then, Mr. Putnam, since it has been stipulated that there is a requirement that the prime contractor must furnish you as the representative of the Corps of Engineers a list of its subcontractors on the project, pursuant to request, did you make a request for such a list?

A. I did.

Q. And was such a list furnished you?

A. It was.

Q. And by whom was the list furnished to you?

A. Ashton-Mardian Company.

Q. And Ashton-Mardian is the joint venture that had the prime contract on that job, was the one that had the contract with the United States Government on the job? A. Yes, sir.

Q. In reference to that list was the Pioneer Constructors listed on there as a subcontractor?

A. Yes, sir.

Mr. Johnson: At this time I think the record should show an objection to the question. I think the list itself would be the best evidence.

Q. (By Mr. Thompson): Mr. Putnam did you bring a copy of the list with you? [10]

A. Yes, sir.

Q. You were subpoenaed to bring it, were you not? A. Yes, sir.

(Plaintiff Armco's Exhibit 1 marked for identification.)

Q. (By Mr. Thompson): Mr. Putnam, I hand you a list marked Plaintiff's Exhibit 1 for identifi-

(Testimony of D. G. Putnam.)

cation and ask you if that is a signed carbon copy of the list which was furnished you by Ashton-Mardian Company pursuant to a request for a list of subcontractors? A. Yes, sir.

Q. And what is the date that appears thereon?

A. 25th of September, 1956.

Mr. Thompson: We offer this in evidence at this time, your Honor.

Mr. Johnson: We object to the offer on the grounds of immateriality. All this evidence does is show the Pioneer Constructors was a subcontractor on September 25th, 1956, which I believe is admitted by all the pleadings. The offer is entirely incompetent and immaterial for any other purpose.

The Court: Is this preliminary, Mr. Thompson?

Mr. Thompson: Yes, it is, your Honor.

The Court: I will receive it for that purpose.

(Plaintiff Armco's Exhibit 1 marked in evidence.)

The Court: It will be marked Plaintiff Armco's Exhibit 1 in evidence. [11]

Q. (By Mr. Thompson): Mr. Putnam, under the regulation which appears in the specifications, doesn't that provide that if a different subcontractor comes on the job or one is substituted or one leaves that you are to be furnished that information?

Mr. Johnson: We object to that on the ground I think the contract itself is the best evidence of what that provides.

Q. (By Mr. Thompson): Mr. Putnam, you are

(Testimony of D. G. Putnam.)

familiar with the regulations of the United States Government in reference to the duties of a prime contractor on a United States project, are you not?

A. Yes, sir.

Q. Is there a regulation which requires the prime contractor to keep the representative of the United States Government informed as to the subcontractors that are doing work on the project?

Mr. Johnson: If the Court please, we object on the ground the regulation itself should be offered if it is material, rather than the recollection of this witness.

The Court: The regulation would be the best evidence.

The Witness: I don't see it in there.

Q. (By Mr. Thompson): Mr. Putnam, do you know what that regulation is that we have been discussing here?

Mr. Fickett: Same objection, if the Court please.

The Court: What regulation are you talking about, [12] Mr. Thompson?

Mr. Thompson: I am asking him about the regulation requiring the prime contractor to furnish a list of subcontractors.

The Court: There is no evidence of any such regulation. Let's get the regulations if there are any.

Mr. Thompson: They are supposed to be a part of that particular contract. However, that is apparently just a portion of the actual job specifications on it. They were included in the copy which Mr.

(Testimony of D. G. Putnam.)

Putnam has, which constitutes the entire contract. And I assumed that those would be in there, but they are not. We checked it the other day and saw that those regulations were a part of that particular contract.

The Court: You are not bound by this contract. If the actual contract has those in there, get the actual contract.

Q. (By Mr. Thompson): You didn't bring the contract with you?

A. No, I brought a copy of this letter; it quotes the contract.

Q. I see.

A. Which I wrote to the prime contractor.

Q. All right.

Mr. Thompson: We had a stipulation that there was a regulation or requirement that the prime contractor had [13] to furnish a list of its subcontractors to the project engineer, did we not?

Mr. Catlin: Yes.

Mr. Johnson: On demand?

Mr. Thompson: On demand, right.

Mr. Catlin: On request.

Q. (By Mr. Thompson): Now, Mr. Putnam, pursuant to that regulation which we have just mentioned in the stipulation here, did you request a list of the subcontractors from the Ashton-Mardian Company? A. Yes, sir.

Q. How was that request made?

A. By letter.

Q. Did you bring a copy of that letter with you?

(Testimony of D. G. Putnam.)

A. Yes, sir.

Q. When you wrote this letter was it sent to the Ashton-Mardian Company?

A. It was sent—I don't remember the exact address. I have it here.

Q. Was it sent to the Ashton Company and the Mardian Company?

A. Ashton Building Company, Mardian Construction Company.

Q. The original of that letter then was mailed to Ashton-Mardian, is that correct?

A. Yes, sir. [14]

Q. And addressed as indicated on your copy of it?

A. Yes, sir.

Q. And when was this request or this letter written?

A. The 21st of April, 1956.

Q. You wrote the letter, did you not?

A. Yes, sir.

(Plaintiff Armco's Exhibit 2 marked for identification.)

Mr. Fickett: Your Honor, may it be an order for us to request that the contract that the witness looked at be marked for identification at this time, just to keep the record. He made some remarks about it, not being able to find something in it.

The Court: Do you want to have that marked as Plaintiff Armco's 3 for identification?

Mr. Thompson: Yes.

(Plaintiff Armco's Exhibit 3 marked for identification.)

(Testimony of D. G. Putnam.)

A. There is a possibility that might be in there, I didn't search that thoroughly, I didn't find it.

Mr. Thompson: I offer Plaintiff's 2 in evidence.

The Court: Any objection to 2 for identification?

Mr. Johnson: I make an objection at this time to the exhibit and the entire line of testimony, for *their* reason it is immaterial and does not tend to prove or disprove any of the issues in this case. All it could prove is that Ashton-Mardian did or did not notify the Government as to [15] whether or not a certain subcontractor was on the job, which we contend is completely immaterial.

The Court: The objection is overruled. It may be received.

(Plaintiff Armco's Exhibit 2 marked in evidence.)

Q. (By Mr. Thompson): Mr. Putnam, in reference to Plaintiff's Exhibit 2 in evidence, did you advise the Ashton Company and the Mardian Company, the joint venture in this case, of the regulations pertaining to keeping you advised as to the subcontractors on the job?

Mr. Fickett: We object to that, if your Honor please. The letter is there, speaks for itself. Whatever it is, it is.

The Court: Is that what you are getting at, is the letter?

Mr. Thompson: Yes.

The Court: The letter would show what he told him.

Q. (By Mr. Thompson): All right. Mr. Put-

(Testimony of D. G. Putnam.)

nam, as the United States project engineer on the Air Force Station job, were you ever advised that Construction Materials was a subcontractor on that job?

Mr. Johnson: Let the record show the same objection.

The Court: The objection is overruled.

A. I don't remember of having been officially notified.

Q. (By Mr. Thompson): In other words, your official [16] records indicate no reference to Construction Materials, is that right?

A. That is right.

Mr. Johnson: I object. And let the record show the records themselves were introduced.

The Court: The record is the best evidence.

Q. (By Mr. Thompson): Mr. Putnam, as the United States project engineer on the job in question, calling your attention to approximately the 1st of November, 1956, was there any interruption in the work schedule on the job which had been contracted for by the Pioneer Construction Company?

A. None that I remember.

Q. Do you recall whether or not the same supervisory personnel was used on that road construction job during the entire period that it was under construction, that is, aside from a normal change?

A. I believe so, yes, sir.

Q. Did you at any time observe or see a mass exodus of employees off of that job?

A. None other than a normal interruption.

(Testimony of D. G. Putnam.)

Q. And did you see any change in construction equipment other than changes that resulted normally from the progress of the work as it progressed? A. No, sir.

Q. Then from your observation was there anything that [17] would indicate to you or to a person simply from observing the working of the men, the equipment, supervisory personnel, that would indicate to anyone that there was a change in subcontractors on that road construction job during any particular period of time while that road was under construction? A. No, sir.

Mr. Thompson: That is all.

Cross Examination

Q. (By Mr. Catlin): Mr. Putnam——

The Court: Pardon me, Mr. Catlin. I suggest you let the plaintiffs go ahead first. Do you have any questions, Mr. Carr?

Mr. Carr: If the Court please, it is my understanding that all testimony of all witnesses, whether for Armco or Apache becomes a part of the record in both cases.

The Court: That is right.

Mr. Carr: So it is not necessary to go over the——

The Court: No. We would be here forever.

Mr. Catlin: Do I understand, your Honor, that is the way you would like to proceed, to have both the plaintiffs question each witness?

The Court: In that way we won't be going back

(Testimony of D. G. Putnam.)

and forth. In other words, if Mr. Thompson should have overlooked [18] anything or if he didn't develop something Mr. Carr thought should be brought out, then all of the witnesses' testimony on direct would be in for cross examination.

Mr. Catlin: There is no question about the fact that myself as representing the prime contractor and Mr. Johnson as representing the third party defendant will both be able to question the witnesses also, is there? I say that in view of the other ramifications that are in this case.

The Court: I am going to be liberal to Mr. Johnson in his questions because he has a stake in the matter.

Cross Examination

Q. (By Mr. Catlin): Mr. Putnam, I notice part of this letter which is marked Plaintiff Armco's Exhibit No. 2, the provision that payrolls are to be submitted with the proper affidavit, both by the prime and the subcontractors, is that correct?

A. That is correct, yes, sir.

Q. Was that done in this particular case?

A. To the best of my knowledge it was.

Q. Do you know whether or not the Pioneer submitted their certified payrolls?

A. I am satisfied they did, yes, sir.

Q. Do you know whether Construction Material submitted certified payrolls to you through your office? [19]

A. They submitted payrolls; I don't remember back to 1956 any particular instance.

(Testimony of D. G. Putnam.)

Q. You don't remember whether or not that the payroll submitted by Construction Materials started with any particular date, is that correct?

A. That is correct, yes, sir.

Q. Then with the submission of those payrolls you were aware that Construction Materials was on the job?

A. I would be, yes, sir.

Q. Your answers then to Mr. Thompson that you were not aware of any change would be modified by the fact that you had received payrolls from Construction Materials?

A. I personally don't see those payrolls.

Q. Do they go through your office?

A. Yes, sir.

Mr. Catlin: I have no further questions.

Cross Examination

Q. (By Mr. Johnson): I believe you stated in answer to a question that counsel asked that you were never officially notified that Construction Materials was a subcontractor on that job; I take it you were then unofficially notified?

A. I don't remember of having been officially notified and I don't remember how I was notified.

Q. But you were notified some way, it was called to your attention that Construction Materials was a subcontractor on the job, is that correct?

A. I don't remember if I heard it in town or on the job.

Q. Anyway you did hear it?

A. I knew they were on the job, yes, sir.

(Testimony of D. G. Putnam.)

Q. Can you tell us when it was you first knew that? A. No, sir.

Q. Did you make any request or demand then of Ashton-Mardian to furnish you with that official information?

A. Not above and beyond the original request.

Q. In other words, you didn't take their failure to notify you very seriously then? A. No, sir.

Q. One more question. It isn't the custom of the subcontractors or prime contractor to furnish you a list of the materialmen from whom the subcontractor is purchasing material, is it?

A. Not the material people. They furnish us drawings and equipment lists for approvals.

Mr. Johnson: That is all.

Mr. Carr: I am sorry, I didn't get that.

The Witness: They furnish shop drawings and equipment for approval as required by the contract specifications. Various sections of the specifications require these lists [21] be furnished.

Redirect Examination

Q. (By Mr. Carr): In this case were the estimates of Apache Powder Company submitted by Pioneer or Ashton-Mardian?

A. I don't believe so, sir. That is material that has not been incorporated into the work and wouldn't require approval.

Mr. Carr: That is all.

(Witness excused.) [22]

* * * * *

GERARD JOHN STURM

called as a witness herein, having been first duly sworn, testified as follows: [30]

* * * * *

Cross Examination * * * * *

Q. (By Mr. Johnson): You mentioned a gentleman named Jim in this letter.

A. Jim Ammon, right. I didn't read it to refresh my memory, but Jim Ammon was hired to cover the southern part of the State when we took Bill Johnson and brought him up north. At that time Jim Ammon was in the southern part of the State, which included Tucson. I met him and went out to Pioneer's office, to Mr. Skorpick's office and discussed the account, which that letter relates.

Q. What was said by you and by Mr. Skorpick on that occasion in regard to the Ajo account?

A. It is covered in the paragraph and I think it is indicated he was going to pay it.

Q. Was anything said in that conversation in regard to who was, or who was not the subcontractor on the Ajo job at that time?

A. Absolutely not.

Q. Was Construction Materials Company mentioned? A. Not in any way.

Q. Are you familiar with the shipment which was made by your company to the Ajo job during the month of December? A. Yes.

Q. Who ordered that shipment to be made?

A. I did.

Q. And who on the job out there asked you to have it done? [43]

(Testimony of Gerard John Sturm.)

A. Well, there wasn't anybody on the job. My trip on December 14th was the result of having tried to get ahold of Mr. Skorpick in relation to the account, and I called him on December 10th.

Q. You called who?

A. Mr. Skorpick. December 10th was a Monday and the 14th was Friday. I tried to call Mr. Skorpick at his office in Tucson from our office in Phoenix and he was not in. And Mel Simmons usually in there and I talked to him about the account because we had talked to him about the account before and his never being able to give us any money. So I talked to Mel at that time. It was requested the shipment was short these materials that we shipped on the 13th from L.A.

Q. Isn't it true, Mr. Sturm, on that occasion Mr. Simmons advised you that the Construction Materials Company had taken over the job and at that time was subcontractor on the job?

A. Absolutely not.

Q. Isn't it true that Mr. Simmons told you the Pioneer Constructors were no longer on the job?

A. No, sir.

Q. You are positive that neither of those statements were made by Mr. Simmons?

A. Positive. The first information I ever had was the day as a result of that telegram.

Mr. Johnson: Mark this for identification, please. [44]

* * * * *

HAROLD ASHTON

called as a witness herein, having been first duly sworn, testified as follows:

Cross Examination

Q. (By Mr. Thompson): State your name, please. A. Harold Ashton.

Q. Mr. Ashton, do you have any connection with the Ashton Company? [50]

A. I am the president of that company.

Q. That is the same company that formed the joint venture with the Mardian Construction Company on this Air Force project TM-181 at Ajo, Arizona? A. That is right.

Q. The two companies were the joint venturers which had the prime contract with the United States Government on that job, is that right?

A. Right.

Q. Mr. Ashton, as president of the Ashton Company and as a part of this joint venture, isn't it true that the detail of contracts and things related to negotiations, and so on, were carried on primarily by you for the Ashton-Mardian Company in relation to that job? I am contrasting that as to the Mardian Company in that respect.

A. I would say that is right.

Q. Now, as the prime contractor on that job, the Ashton-Mardian Company, you entered into a contract with the Pioneer Constructors, the Pioneer Construction Company, for a portion of the work under the prime contract, did you not?

A. That is right.

(Testimony of Harold Ashton.)

Q. And that contract is dated, was dated March 30, 1956? A. You mean our prime contract?

Q. No, I am speaking of the subcontract between yourself and the Pioneer Constructors. [51]

Mr. Catlin: Those are part of the records.

The Court: They are in the envelope there.

Q. (By Mr. Thompson): Now, in regard to your entering into a contract with Pioneer Constructors, did you take bids on the portion of the work that was covered in that particular contract, call for bids on it?

A. We did not call for bids on it; some bids were submitted to us.

Q. Do you recall approximately how many bids were submitted covering the work that is covering in your Pioneer subcontract?

A. To my knowledge we didn't receive another bid that covered all the items that were covered in this contract. However, combination of other bidders would have totaled the same units of work.

Q. Well, you entered into the contract with Pioneer Constructors because, if I understand correctly, at that particular time you believe that was to the best advantage of the Ashton-Mardian Company, is that right? A. That is right.

Mr. Thompson: What was the stipulation in regard to these, they were true copies?

Mr. Catlin: As I understand it was stipulated they could be received in evidence.

Mr. Thompson: That is what I understood. Will you [52] mark these in evidence?

(Testimony of Harold Ashton.)

The Court: They may be received.

(Plaintiff Armco's Exhibits 6 and 7 marked in evidence.)

Mr. Thompson: For counsel, the Pioneer Constructors' contract is Armco 6; Construction Materials' contract is Armco's 7.

Q. (By Mr. Thompson): Mr. Ashton, I have handed you Armco's Exhibit 6 in evidence, being a subcontract executed between your company and Pioneer Constructors, and ask you in relationship to that particular contract, on the first page of it, this was your subcontract agreement number 7, is that right, the number being indicated in the upper right hand corner? A. That is right.

Q. And the second sheet there is entitled: "Supplemental Sheet to Subcontract No. 7," Is that right? A. That is right.

Q. In reference to the items that appear on your first part of it there, are those sections of the specifications referred to in the prime contract?

A. That is right.

Q. And then as a general statement the items that are listed on your supplemental sheet, subcontract No. 7, being the second page of this subcontract, are those the items required to carry out the provisions of the specifications [53] listed on the first page there?

A. The sections listed on the first page are the governing specifications for the performance of the work listed on the second.

Q. This subcontract, as I understand it, applied

(Testimony of Harold Ashton.)

principally to the construction of the roadway on the Ajo job, is that right? A. That is right.

Q. There is some building excavation included I believe in here, but the principal portion of it is the roadway, is that right? A. That is right.

Q. And in reference to the negotiations pertaining to the actual execution of Armco's No. 7 in evidence, what was the personnel you dealt with, or who were they you dealt with on behalf of Pioneer Constructors?

A. I dealt with Mr. Skorpick and Mr. Moore.

Q. Mr. Skorpick was president of Pioneer Constructors? A. That is right.

Q. And Mr. Moore vice president?

A. Right.

Q. Do you recall, Mr. Ashton, in reference to the pipe which is listed under bid items on the second page of the Pioneer contract, Armco's No. 7 in evidence, do you recall whether or not the Ashton-Mardian Company paid Pioneer for [54] the major part of the pipe listed there?

A. To my knowledge we did.

Q. This contract is dated March 30, 1956. Do you recall whether or not it was actually executed on that date?

A. I don't believe that it was executed on that date.

Q. Do you know approximately when it was executed?

The Court: When you speak of "this contract", what do you mean, Mr. Thompson, what number?

(Testimony of Harold Ashton.)

Mr. Thompson: I am speaking of Armco No. 7 in evidence, the Pioneer Constructors'.

The Court: That is 6. I think you referred to it several times as 7. It should be 6.

Mr. Thompson: Let the record show that I have referred to nothing except Armco's No. 6 in evidence, being the Pioneer Constructors' contract, up to this point.

The Court: By that you mean you have intended to refer to it?

Mr. Thompson: I have attempted to, yes. I am getting confused, because the contract has the number 7 on it.

Q. (By Mr. Thompson): In reference to Armco's No. 6 in evidence, being the Pioneer Constructors' contract, I believe I asked you, do you recall approximately when it was executed; did you answer that question?

A. I believe I did and I believe I said I wasn't certain when it was executed. It was written at this date and it may [55] not have been finally executed until the performance bonds were executed.

Q. I see.

Do you recall when the performance bond was executed?

A. I don't recall the date, but we have a copy of the bond and it is dated.

Q. That was, in any event, some time after the date of March 30, 1956? A. That is right.

Q. As a practical matter, in the execution of Armco No. 6 in evidence, was this contract typed

(Testimony of Harold Ashton.)

up at the Ashton-Mardian Company offices? In other words, did you prepare——

A. To my best knowledge this contract was typed up at the Tucson office, because on March 30th we had not as yet established an office at the project.

Q. That is the Tucson offices of the Ashton-Mardian Company? A. That is right.

Q. In the execution of the contract would you, on behalf of the Ashton-Mardian Company, sign the contract prior to the time the subcontractor signed it? A. Not ordinarily.

Q. Do you recall in this case, referring to the Pioneer Constructors' contract, who signed it first?

A. I don't recall, but I assume Mr. Skorpick would have [56] signed it first.

Q. And your normal procedure would be it would be signed by him and returned to you, or would it be done in your presence?

A. No, it would be signed by him and returned to me with a copy of the bond, and at that time I would sign it or my authorized representative of the company would sign it.

Q. Then as a practical matter you didn't sign your subcontracts until you got the executed copies back from the subcontractor and a copy of his performance bond? A. That is right.

Q. Mr. Ashton, I now hand you Plaintiff Armco's Exhibit No. 7 in evidence, and ask you in reference to that contract, it is dated November 1, 1956, I believe, is it not? A. That is right.

(Testimony of Harold Ashton.)

Q. That particular contract, being Armco No. 7 in evidence, is I believe your subcontract agreement No. 128, is that correct? A. That is correct.

Q. And in reference to Armco No. 7 in evidence, the Construction Materials' contract, do you recall whether or not the Ashton Company approached the Construction Materials Company or representative of the Construction Materials Company approached the Ashton Company in the negotiation of this contract? [57]

A. The Construction Materials—well, let me say Mr. Skorpick and Mr. Moore approached the Ashton Company.

Q. This is the same Mr. Skorpick and Mr. Moore you have previously named as being president and vice president of the Pioneer Constructors, is that correct? A. That is right.

Q. Do you recall approximately when they approached you?

A. I can't recall the exact day, but to the best of my knowledge it was during the latter part of November of 1956.

Q. When you say the latter part, are you speaking of, say, the last week of November or last ten days?

A. I would say it would be the last half of November.

Q. In other words, as I understand your testimony, you weren't even approached on this contract, which is dated November 1, 1956, until at least fifteen days after that date, is that right?

(Testimony of Harold Ashton.)

A. I would say that is right.

Q. And you were approached by Mr. Skorpick and Mr. Moore, I believe you said?

A. That is right.

Q. At that particular time did you know Mr. Skorpick and Mr. Moore had an interest in Pioneer Constructors Company?

A. I had every reason to believe that they did.

Q. Did you know whether they had a large or small interest, or what? [58]

A. To the best of my knowledge, it was a small interest.

Q. They were not the majority stockholders then? A. Pardon?

Q. They were not the majority stockholders, as you understand it?

A. As I understood it they weren't.

Q. In reference to the Construction Materials Company, did you know whether or not Mr. Skorpick or Mr. Moore had an interest in that company?

A. They told me they did.

Q. What did they tell you?

A. They told me they had a majority interest in that company.

Q. Did they tell you they owned the company?

A. I don't remember that specifically.

Q. But they had a majority interest in the company? A. They controlled the company.

Q. They controlled the company. What reason did they give you for asking you at this time to

(Testimony of Harold Ashton.)

enter into a subcontract with the Construction Materials Company?

A. The reason they gave me was the fact that for some time they had been trying to make a deal with the majority stockholders and Pioneer Constructors to liquidate that company, or to buy them out and that it was agreeable with Pioneer Constructors, it was agreeable with the surety [59] company and it was agreeable with them they assume the balance of the work required to be done on this particular project. It was to their advantage to make this change; it was not to our advantage to keep them from making the change. We were dealing with the same people who had originally entered into a contract with us and we had the same surety company as agreed to protect us and we saw no reason to not make the change, as it was desirable to them.

Q. As I understand it, they advised you that Pioneer Constructors wanted to liquidate, is that right, or wanted to get out of the construction business?

A. Well, whether they wanted to get out of the construction business or liquidate, I don't recall if they specifically said that in so many words. The main element of the case being the fact that they wanted to get out of it.

Q. You mean Mr. Skorpick and Mr. Moore wanted to get out of the Pioneer Constructors Company?

A. That is right.

Q. Had you dealt with any other representatives

(Testimony of Harold Ashton.)

of the Pioneer Constructors up to this time aside—— A. No, I hadn't.

Q. I mean as officers as such? A. No.

Q. Were you approached, during this period of time were you approached by anyone other than Mr. Skorpick and Mr. Moore, [60] who purported to represent Pioneer Constructors?

A. I was not.

Q. Then as I understand it, Mr. Skorpick and Mr. Moore came to you, they at that time represented Pioneer Constructors, and advised you they wanted to get out of that company, but at the same time as majority stockholders of the Construction Materials Company they wanted to take over this subcontract which had originally been entered into between your company and Pioneer Constructors, is that a fair statement?

A. I don't know whether that is a fair statement or not. I can't, as I sit here, determine if they came to me as representatives of Pioneer trying to get out of the situation, or representatives of Construction Materials trying to get into one.

Q. At the time they approached you in the latter part of November, you couldn't tell, is that right?

A. That is right. I would say that is right.

Q. Aside from whom they represented in the statement, getting out of one company and coming in as Construction Materials Company and taking over this particular subcontract, eliminating that element, it is correct, isn't it?

A. I believe that is correct.

(Testimony of Harold Ashton.)

Q. Mr. Ashton, I believe the provisions on the back of your first page of your contract, just with Pioneer Constructors, Armco's No. 6 in evidence, provides that you can require the [61] subcontractor to furnish you with receipts for labor and materials at the time this purported change took place between Pioneer and Construction Materials, did you require those? A. We did not.

Q. The reason you didn't of course was that they had a bond protecting you in that regard?

A. I think that was one of the reasons; and the other was we had no reason to believe there were any outstanding bills due.

Q. You weren't advised of outstanding obligations of Pioneer Company at that time?

A. We were not.

Q. Now, Mr. Ashton, in comparing the two contracts, that is, Armco No. 6 in evidence and Armco No. 7 in evidence, aside from the fact that a different date appears on the first page and a different company is named, the amount of money being different, these contracts refer to the same specifications of the prime contract, do they not?

A. That is right.

Q. Now, on page 2 of Armco's No. 6 and No. 7 in evidence, in comparing those two, they relate to the same work required to meet those specifications, items that are listed on page 1, do they not?

A. They refer to the balance of the work required to [62] complete them.

Q. In other words, the Construction Materials'

(Testimony of Harold Ashton.)

contract, Armco 7 in evidence, covers the balance of the work of the Pioneer Constructors' contract, is that right? A. Repeat that, please.

Q. The Construction Materials' contract, Armco No. 7 in evidence, covers the balance of the work as of November 1, 1956? A. That is correct.

Q. Of the Pioneer Constructors' contract is that correct? A. That is correct.

The Court: It is 12:00 o'clock. We will recess until 1:30.

(Whereupon a recess was taken at 12:00 o'clock noon until 1:30 o'clock p.m.) [63]

Afternoon Session, 1:30 o'clock p.m.

March 4, 1958

Mr. Fickett: Your Honor, I may want to be excused during the afternoon. I would like the record to show that we have no objection to the trial going on in any of its stages, whether Pioneer is represented by counsel or not.

The Court: Very well. The record may show that counsel for Pioneer is given permission to withdraw at any time. The trial will proceed in the absence of Pioneer's counsel.

Mr. Carr: I wonder if I can ask counsel for Pioneer where Mr. Skorpick is, if he knows? I understand the subpoena duces tecum has been issued and the Marshal has been unable to serve him over a period of several days and know whether or not Mr. Skorpick knew of the trial on this day and where he is.

Mr. Fickett: I know nothing, because Pioneer and Skorpick have nothing to do with each other at the present time and I do not represent Mr. Skorpick or Construction Materials. He is president of Construction Materials Company and I have absolutely nothing to do with that insofar as any representation is concerned. [64]

HAROLD ASHTON

having been previously sworn, resumed the stand and testified further as follows:

Cross Examination—(Continued)

Q. (By Mr. Thompson): Mr. Ashton, in comparing these two contracts, that is the Armco No. 7 in evidence, the Construction Materials Company contract and Armco No. 6 in evidence, the Pioneer Constructors' contract, on the supplemental sheet which is the second page of the contract, do you have those before you? A. No.

Q. I believe you previously testified that the Pioneer Constructors' contract was your subcontract agreement No. 7, did you not?

A. That's right.

Q. You also testified that your subcontract agreement No. 128 was the Construction Materials' contract, did you not? A. That's right.

Q. In comparing these two contracts, I notice that your supplement sheet, subcontract No. 7, which is the second page of the Pioneer Constructors' contract, Armco No. 6 in evidence, contains

(Testimony of Harold Ashton.)

the identifying line at the top, supplement sheet to [65] subcontract No. 7, isn't that right?

A. That's right.

Q. Then referring to the Construction Materials' contract, Armco No. 7 in evidence, your subcontract No. 128, that same identifying line, supplemental sheet to subcontract No. 7, appears on the Construction Materials' contract, does it not?

A. Yes, it does.

Q. Then it is clearly apparent from the evidence that these two contracts related to the same subcontract on the Air Force Job, isn't that right?

Mr. Johnson: If the Court please, I object to that as calling for a conclusion of the witness. It is pretty clearly in evidence that there are two subcontracts.

The Court: Objection sustained.

Q. (By Mr. Thompson): It is clearly apparent that they relate to the same work on the Air Force Job aside from the fact that a portion has already been completed by Pioneer by the time the second subcontract was signed?

A. I wouldn't say that. I think this probably in error. I think probably that when this second contract was drafted, the engineer that handed it to the typist probably made an error and on this Construction Materials' contract, that probably should have said, "supplemental sheet to subcontract No. 128," but it was being copied off this same sheet only [66] with different quantities and probably the typist just failed to note that. I hadn't noted it before.

(Testimony of Harold Ashton.)

Q. I believe you had testified that these two contracts related to the same work?

A. There is no question about that.

Q. Mr. Ashton, in regard to the two contracts which we are discussing, I notice the Pioneer contract was for a sum in the amount of \$401,217.83, isn't that correct? A. That is correct.

Q. The Construction Materials' contract is for the amount of \$266,391.66, isn't that correct?

A. That's right.

Q. As far as the Ashton-Mardian Company was concerned, does that \$266,000.00 on the Construction Materials' contract represent the balance of the \$401,000 of the Pioneer subcontract?

A. That's right.

Q. Mr. Ashton, calling your attention to the period of approximately November 1, 1956, was there any change in personnel on the road construction work on the Ajo contract other than what would normally occur in construction work?

A. Not to my knowledge.

Q. Was there any change in the supervisory personnel?

A. No change due to this change.

Q. Let me ask you in regard to equipment. On the road [67] construction equipment that was being used there, was the same equipment continued in use under the second subcontract as was used under the first except what would normally be not used because of the progress of the work?

A. To my knowledge it was.

(Testimony of Harold Ashton.)

Q. In other words, there was no mass turn over of equipment there? A. I don't believe so.

Q. In regard to the equipment used on the job, was the equipment marked with the Pioneer Constructors' name on it?

A. Some units had that name on it.

Q. Did the Pioneer Constructors' name appear on the equipment throughout the course of the work?

Mr. Johnson: At this time, your Honor, let the record show an objection to the questions as to the names on the equipment for the reason it is highly immaterial. I think the evidence is that the plaintiff's representatives had their negotiations in the Tucson office and by phone anyway. So there is no theory they could have been misled by the markings on the equipment.

The Court: He may answer.

Q. (By Mr. Thompson): Did the Pioneer Constructors' name appear on the equipment, let us say through the month of December, 1956?

A. To my knowledge it did. [68]

Q. To your knowledge did any of the road equipment, was it marked with the name Construction Materials Company?

A. This is during December?

Q. Yes, up through December, 1956.

A. I just can't remember that. There were some few pieces of equipment that came on the job I think before the end that did have the name Con-

(Testimony of Harold Ashton.)

struction Materials Company on them, but I can't remember what they were or when they arrived.

Q. When you say before the end, are you referring to the end of the road construction or the end of December?

A. The end of the road construction.

Q. Do you recall whether or not that equipment came on the job before the end of December or after the end of December?

A. You mean some equipment with Construction Materials' name on it?

Q. Yes.

A. As I recollect, it was after the first of the year.

Q. As a result of the execution of the second subcontract on this job, was there any interruption in the construction schedule on the roadway?

A. No interruption.

Q. It continued right on without interruption then?

A. That's right. [69]

Q. Calling your attention to the negotiations leading up to the execution of the Construction Materials' contract, which is Armco No. 7 in evidence, I believe you previously testified that you were first approached in regard to negotiating a new contract there the latter part of November, 1956, is that right?

A. That's right.

Q. And at that time you were approached by Mr. J. E. Skorpick and Tom Moore, is that right?

A. That's right.

(Testimony of Harold Ashton.)

Q. I believe you previously testified that they were the president and vice president of Pioneer Constructors Company? A. That's right.

Q. And also of Construction Materials Company? A. That's right.

Q. In reference to their advising you that they wanted to take over as Construction Materials Company the work of the Pioneer Constructors on this job, you previously testified you didn't see any disadvantage to Ashton-Mardian in taking it over since it would continue the same personnel and equipment and so on. What did you advise Mr. Skorpick and Mr. Moore in regard to that?

A. I discussed this thing with the other principals and advised him if he wanted to take this course we would have to establish a severance date of some kind which would necessarily [70] have to be the end of a given thirty-day period because that is the only time any quality analysis is provided or available, and it was our feeling that he would have to provide a surety bond preferably from the same people that wrote the original bond to Pioneer Constructors for the performance of the balance of the work.

Q. That would be so there would be no lapse from the bond already on Pioneer Constructors and beginning a new bond for Construction Materials, is that correct? A. That is correct.

Q. Did you advise them, did you agree the latter part of November that if the bond was secured that upon a contract being executed, that it would relate

(Testimony of Harold Ashton.)

back to November 1, 1956 or did you select the date at that time?

A. I can't remember just in what discussion we had, I mean what discussion the date was determined, whether it was at this first discussion, I mean as soon as this issue became a fact, why, a great amount of conversation was continuously going on probably on a daily or every other day basis as to what we were going to do and what date would be the cut off date, and I would say that in subsequent discussions from some time prior to the 1st of December probably, we decided on this October 31st date.

Q. Then since a new contract was executed, I assume that the new bond was obtained, is that right? [71]

A. That's right.

Q. Do you know approximately when that bond was obtained?

A. The final bond, according to the information I think we have, was obtained January 8th, wasn't it?

Q. Of 1957?

A. Of 1957.

Q. Then if I recall, or isn't this a fact, that you received the copy of the bond and the contract back executed sometime around the 1st of the year. This is the Construction Materials' contract I am speaking of.

A. It must have been somewhere around the 8th of January.

Q. Then when you received it back, you executed it, isn't that correct?

A. That is correct.

(Testimony of Harold Ashton.)

Q. That was around the 8th of January, 1957?

A. I believe that is correct.

Q. As I understand it in your discussions regarding the bond, this Construction Materials' contract was contingent upon the Construction Materials Company getting the bond, is that correct?

A. That is correct.

Q. In other words, if they had not obtained the bond on or about January 8th, 1957, Pioneer Constructors would have been continued on the job and responsible to you as a prime contractor? [72]

Mr. Johnson: Let the record show an objection to that question as calling for a conclusion stating facts not in evidence, that Pioneer Constructors would have continued on the job. I think the evidence is that Pioneer Constructors was off the job then and Construction Materials Company was on.

The Court: I think we should know that. I don't think there is any evidence either way, if they were or weren't. Was work going on from November 1 right up to January 8th?

The Witness: That is right.

The Court: There was no cessation of work?

The Witness: No.

The Court: But actually your contract with Construction Materials was entered into, I mean actually executed by you on January 8th or about that time?

The Witness: That's right.

The Court: Objection overruled.

(Testimony of Harold Ashton.)

The Witness: We would have had no other course to take. Evidence also proves the fact that by virtue of the fact that no payments were made to these people until such time as the new bond was furnished and the contract executed.

Q. (By Mr. Thompson): That is my next question. I was going to ask you if you recall approximately when your last payment was made to the Pioneer Constructors?

A. Mr. Catlin has that. The last payment was made to [73] Pioneer Constructors on the 26th day of November for work completed as of the 31st day of October, both 1956.

Q. When was the first payment made to Construction Materials Company?

A. The first payment was made January 24, 1957. It was January 29th, 1957.

Q. In other words, you made no payments to Construction Materials until after the contract was signed on January 8th, 1957?

A. That is correct.

Q. Mr. Ashton, do you recall the conversation between yourself and Jerry Sturm on March 11, 1957? A. I do.

Q. At that time did Mr. Sturm advise you that Pioneer Constructors owed Armeo?

A. He did.

Q. The amount of \$16,411.84? A. He did.

Q. At that time did you advise him that you would do all in your power to see they were paid?

A. I did.

(Testimony of Harold Ashton.)

Q. Out of the retention moneys? Did you say yes?

A. I did. I wouldn't specifically say out of the retention moneys. I would say all in my power to see they were paid. [74]

Q. Did you advise Mr. Sturm that there was bond coverage in effect which would protect Armco?

A. I did.

Q. During the course of that conversation did you explain to him or tell him that the Pioneer contract terminated on October 31, 1956 and a Construction Materials Company contract became effective on that job November 1, 1956?

A. I believe I did.

Q. Did you any time prior to that notify Armco of this change in subcontractors on that job?

A. I don't believe we did. I don't believe I did.

Mr. Thompson: That is all.

Cross Examination

Q. (By Mr. Carr): Mr. Ashton, this may in part be repetitious, but I don't believe the specific point was covered. You have been examined in regard to the subcontract to Pioneer of March 30, 1956 and the subcontract to Construction Materials which bears date of November 1, 1956. Have you at any time examined the face of these contracts to determine that work required to be done is identical as appears on the face of the contract?

A. We know that.

(Testimony of Harold Ashton.)

Q. It is you know it and it is identical?

A. It involves the same units of work on a continual basis [75] from a stopping point on.

Q. You previously explained that the reference on the first page was to the section numbers of the contract and the reference on the supplemental sheet was to bid items mentioned in the contract?

A. That's right. I said on the sections on the first page governing specifications for the performance of the work to be done, under these six items.

Q. In connection with these two subcontracts, the bid items were the same, were they?

A. They were the same.

Q. And the quantity items were different?

A. That's right.

Q. For the reason part of the work had been done? A. That's right.

Q. The unit prices were the same?

A. That's right.

Q. And, of course, the quantities multiplied by unit prices carried out would give different sums and give different totals? A. That's right.

Q. In your examination by Mr. Thompson I believe you made the statement, Mr. Ashton, that it would be to the advantage of Construction Materials Company to make the change. Will you explain that statement a little more in detail? [76]

A. Well, due to the fact that Skorpick and Moore were principal owners of Construction Materials Company and were desirous of severing

(Testimony of Harold Ashton.)

their relations with Pioneer Constructors, and apparently this being the only major project that was then under contract that had a large amount of work yet to be done, had a change of this type not been made at that time, their relations and their connection with Pioneer Constructors would then have had to be maintained for an indefinite period of time. I mean they would as of this date today still would have had interest in Pioneer Constructors that they would have had to contend with. And it was desirous as far as they were concerned to be able to sever the thing.

Q. At the time of these negotiations, Mr. Ashton, did you have any information as to the financial status of Pioneer Constructors?

A. We had no information.

Q. I ask you if you didn't say on your deposition that you knew within a couple of months after the March 30th subcontract that Pioneer was in bad financial condition?

A. I said I believed that, I had heard by rumor that there was a situation of this kind, but we had no way to base it on fact. We had no letter of any kind from anyone saying a bill had not been paid and we had no telephone calls from anyone I can remember that were concerned about this particular project or any of the work we had done with them. [77]

Q. Was there anything to indicate that the bills were being paid? A. Probably not.

Q. You actually did not make any investiga-

(Testimony of Harold Ashton.)

tions to determine whether Pioneer had paid to suppliers?

A. No, we made no investigation. I mean, after all, people like yourself know these people better than we do. You have been selling to them for years. I have no way of finding out as much as a vendor.

Q. Did you consider the matter of any concern to Ashton-Mardian?

A. I can't say I wouldn't consider anything a matter of no concern to Ashton-Mardian. Under the circumstances, we felt we were adequately protected with the surety bond, that it would protect us in case the bills were not paid.

Q. You were relying on your Hartford surety bond on the subcontract, is that correct?

A. I would say we were relying on it. No different than in our prime contract. The Government doesn't get a financial statement from us. If we give them a bond, they give us a contract.

Q. Are you now familiar with the provisions of the Miller Act?

A. I would say reasonably familiar.

Q. The Act in effect gives the subcontractor ninety days [78] within which to pay his bills, settle up with his suppliers and laborers before any action can be filed or anything can be done looking toward the collection of claims of the suppliers against him, doesn't it?

A. That is my understanding.

Q. During this ninety day period if Ashton-

(Testimony of Harold Ashton.)

Mardian continued to pay the subcontractor and the subcontractor did not pay the money to the supplier, using it for some other purpose, and the claim was filed by the supplier, you would be stopped under the payment bond to the Government, wouldn't you? A. That is——

The Court: That is a legal question, Mr. Carr.

Mr. Catlin: We have no objection to his answering it.

The Court: I don't think it is going to get us anywhere.

Mr. Carr: My intent, your Honor, was to ask if he understood that, but we will let it go.

Q. (By Mr. Carr): Now, you were questioned in regard to the amount of the Construction Materials subcontract, 266,000 and odd dollars. How was that figure fixed, Mr. Ashton?

A. That was based upon the estimated percentages of completion and the estimated unit quantities of completed work as of October 31st, 1956.

Q. Who made those estimates to start with?

A. Our engineer made the estimates to start with, probably on or about the 25th of October. They were probably turned in to the resident engineer, Mr. Putnam's office on the 31st of October for their engineer to check, and to affirm as to correct quantities and processed for payment shortly thereafter.

Q. When you were negotiating for the Construction Materials' subcontract, this figure was the

(Testimony of Harold Ashton.)

last one you had with respect to completion of work? A. That's right.

Q. And that figure, does it bear any relation whatsoever to the situation existing on January 8th, 1957 as to the completion of work?

A. No, I wouldn't say it does, because there had been a considerable amount of work done during the months of November and December.

Q. You were also questioned in regard to change in management, personnel, equipment and suppliers on this job after November 1, 1956. I believe you said there was no material change not due to change in the type of work performed. Was that a condition of your agreement with Skorpick and Moore to give them the subcontract to Construction Materials, a condition that the work proceed by the same management, personnel, equipment?

A. That wasn't a condition.

Q. In answer to a question by Mr. Thompson you said that if the Hartford bond on the Construction Materials contract had not been executed on January 8th, 1957, Pioneer would have been continued responsible on the job. Did you, in fact, hold Pioneer responsible on the job up to the time when you executed the Construction Materials contract, subcontract on January 8th, 1957?

Mr. Johnson: I object as conclusion of the witness. He can testify what he did, if that constitutes holding anyone responsible.

The Court: You mean he in his judgment believed that the contract of Pioneer was binding

(Testimony of Harold Ashton.)

and in effect until January 8th, 1957, is that what you mean?

Mr. Carr: The intent, your Honor, is this: To establish if possible that Ashton-Mardian Company actually held Pioneer responsible for this work until the moment the new contract was executed on January 8th, 1957.

The Court: He may answer that.

Mr. Carr: That is not a question of conclusion but of fact.

A. When you were dealing with the president and vice president of two separate corporations, both of which are the same people, you aren't splitting hairs quite as fine as you would be if you were getting into an entirely new [81] organization. Our agreement with Skorpick and Moore was that this contract would not, could not, be considered binding until such time as the new surety bond was issued to Construction Materials Company, and the only way we had of governing this thing was withholding of funds, which we did. Had that new bond not been issued, the chances are we would have had at that time to go back to Skorpick and Moore and say, "Here, we can't enter into this contract with you. You can't be bonded. And that was the stipulation under which we agreed to make this change."

Q. (By Mr. Carr): Mr. Ashton, in connection with the operation there at Ajo by Pioneer Constructors and/or Construction Materials, are you familiar with the name of Paul A. Swagerty?

(Testimony of Harold Ashton.)

A. I am.

Q. Who is he?

A. He was the general superintendent for Pioneer Constructors and for Construction Materials Company on the subcontract work done at that project.

Q. He began with Pioneer and continued with Construction Materials? A. That is correct.

Q. Who was West?

A. There was a man named West that was working in the capacity of labor foreman or powderman, something down there. [82]

Q. Does it refresh your recollection?

A. Bill West.

Q. Was he in charge of the drilling and blasting program? A. I believe he was.

Q. Was he in charge for Pioneer before November 1, 1956? A. Yes, he was.

Q. And for Construction Materials Company afterwards?

A. If I remember correctly he became ill on the job or injured or something. When that developed, I am not absolutely certain.

Q. Do you know a man by the name of Thomas J. Dietzman? A. I do.

Q. What is his job?

A. If my memory is correct, I understood he went down there to work somewhat in the capacity of a grade foreman, but whether he actually did that or not, I don't know. He is an equipment operator, an operating engineer.

(Testimony of Harold Ashton.)

Q. Did he work for Pioneer?

A. I believe he worked for Pioneer.

Q. And continued to work when Construction Materials took over the job?

A. I just can't answer that last question. I don't know for sure if he was there that long or not, but I know he was on the job when the job started.

Q. H. Creswell. Do you know who he is? [83]

A. I know an H. Creswell.

Q. Was he working on this Ajo job?

A. I don't believe he was.

Q. Who was he employed by?

A. He was employed by Construction Materials Company as their, I understand, I think he still works in the same capacity; he is managing their ready-mix concrete delivery operation.

Q. Do you know Leo Traffin?

A. No, I don't.

Q. L. L. Witt?

A. I don't know him. I do not.

Mr. Catlin: Do you have many more?

Mr. Carr: I think that is about all the names.

Q. (By Mr. Carr): Bill Knight?

A. I don't know him.

Q. B. Taylor Wilkie?

A. I know Mr. Wilkie.

Q. What position did he hold with what company?

A. To my knowledge he was the—he worked in the capacity of equipment repair and parts expeditor in the shop for Pioneer Constructors.

(Testimony of Harold Ashton.)

Q. Did he ever work for Construction Materials?

A. I imagine that he has because they share the same shop, but I don't know just who was paying him. [84]

Q. Now, Mr. Ashton, do you recall a telephone conversation with me acting as attorney for Apache Powder Company on March 19, 1957?

A. I recall a telephone conversation with you, but I don't recall the date.

Q. Do you recall that I told you that the Pioneer owed Apache money for the job at Ajo and we discussed the matter and told you that I had called Mr. Mardian and Mr. Mardian had suggested my talking with you?

A. I believe I recall that.

Q. Do you recall that after discussing the matter with me you requested that I talk to Mr. Catlin, the Ashton-Mardian attorney?

A. I believe that's right.

Q. Would you say, Mr. Ashton, that the telephone conversation wasn't held on March 19, 1957?

A. I would not say it wasn't, no.

Q. In that conversation do you recall whether or not I told you that Pioneer Constructors owed Apache Powder Company \$25,312.60 for explosives and blasting supplies delivered at Ajo and used at Ajo and that was the balance due at the time?

A. I don't remember specifically the amount. I remember it was in the \$20,000 figure.

Mr. Carr: May we have this marked for identification, please? [85]

(Testimony of Harold Ashton.)

(Plaintiff Apache's Exhibit No. 1 marked for identification.)

Q. (By Mr. Carr): Mr. Ashton, I hand you Plaintiff Apache's Exhibit No. 1 for identification which appears to be a photostatic copy of a letter from Mardian Construction Company to you dated March 19, 1957. Kindly examine it and state whether or not you recall receiving that letter from Mr. Mardian.

A. I received this letter. It has our stamp right on it.

Q. Ashton Building Company was the former name of the Ashton Company, Contractors and Engineers?

A. That's right.

Mr. Carr: We offer this in evidence.

Mr. Johnson: No objection for admitting it for what it is worth. If it be offered as a notice under the Miller Act, certainly we object to it in that capacity, on the grounds it doesn't purport to comply with the terms of the Miller Act.

The Court: Does anybody have any objection for any purpose?

(No response.)

The Court: It may be received.

Mr. Johnson: My objection——

The Court: I understood nobody objected.

Mr. Johnson: I object on the grounds of it being offered for that purpose.

The Court: I asked a moment ago if anybody had any [86] objections for any purpose and there was no answer, so I admitted it.

(Testimony of Harold Ashton.)

Mr. Johnson: I will make no objection at this time.

The Court: Very well.

(Plaintiff Apache's Exhibit No. 1 marked in evidence.)

Q. (By Mr. Carr): Mr. Ashton, do you at this time recall whether or not the original or a copy of that letter was sent to anyone by you?

Mr. Catlin: For the purposes of trying to cut down on time, I think it can be stipulated that a copy or the original, I forget which, was sent by me as representing Ashton-Mardian Company to the Hartford Accident & Indemnity Company.

Mr. Carr: Thank you, sir. We will accept that stipulation.

Mr. Johnson: We will admit we received such a communication.

The Court: The record will show the stipulation.

The Witness: I must say that I didn't know that.

Q. (By Mr. Carr): Has the work on the Ajo job now been completed?

A. I believe everything is completed.

Q. Has there been any final settlement with the Government on the job? A. There has not.

Mr. Carr: That is all. [87]

Cross Examination

Q. (By Mr. Johnson): Mr. Ashton, I assume Mr. Mardian was not an agent or a representative of Apache Powder Company in any sense of the

(Testimony of Harold Ashton.)

word? A. Not to my knowledge.

Q. He was on your side of the project as an associate of yours on this project?

A. He was.

Q. By this letter of March 19th, he was simply stating to you that somebody connected with Apache had orally notified him over the telephone somebody owed him some money?

A. This is a form of inter-office correspondence, you might say.

Q. I believe you stated in your telephone conversation on January 29th with a representative of Armco people, you said that there was some bond coverage which would protect Armco?

A. What date is this?

Q. January 29th, was that conversation you had with a representative of Armco?

The Court: I believe March 11th.

Mr. Johnson: March 11th, that's right.

Q. (By Mr. Johnson): In your conversation on March 11th you stated there was a bond that would protect Armco, is that correct, I think you testified? [88] A. I believe that is correct.

Q. What bond did you have reference to when you made that statement?

A. I was referring to the bond we had with the Hartford.

Q. You were aware of the fact that Hartford bond only protects you? There is nothing in its terms that runs to anybody besides Ashton-Mardian, is that correct?

(Testimony of Harold Ashton.)

A. If it protects me it would protect them.

Q. You are aware of the fact that the bond indemnifies you for any loss you sustained?

A. I think so. We just pay money to the bonding company. We never seem to get any from them, never have.

Q. I believe you stated in response to several questions something to the effect that you might have held Pioneer Constructors responsible on this job until the Construction Materials contract was actually signed. As a matter of fact, nothing ever came up between these dates which caused you to take any action which caused you to hold anybody responsible, did it? A. I believe that's right.

Q. The work was going on, there weren't any hitches and nothing was going wrong, so you didn't have any occasion to know exactly who to hold responsible in case something went wrong and some question came up?

A. I believe you are right. [89]

Q. I assume you have no personal knowledge whatever as to how the people on the job, the representatives of the subcontractor, whichever subcontractor it might have been, how they were dealing with regard to their materialmen or suppliers in regard to their orders or checks or anything of that kind, whether they were dealing as Construction Materials or Pioneer? A. No knowledge.

Q. It was entirely outside your knowledge. Do you *know* their payrolls were being handled?

(Testimony of Harold Ashton.)

A. I don't personally know how the payrolls were being handled.

Q. I believe you said you made your last payment to Pioneer Constructors on November 26th?

A. I believe that is correct.

Q. That paid for everything done on the job up until October 31st? A. That's right.

Q. Normally you would have made another payment during the month of December for another month's work? A. We normally would have.

Q. And the reason you didn't was that you didn't have a contract with Construction Materials and Pioneer was off the job, so you didn't know who to pay it to, is that right?

A. No. I wouldn't say that necessarily.

Q. What was your reason for not paying it?

A. The reason was that we had an agreement that all work done after October 31st should be done by Construction Materials Company, providing they were able to furnish us with a contract and a surety bond for the completion of this contract.

Q. For all you knew it was being done by Construction Materials?

A. For all we knew it was being done by them. We had no access to their accounting procedures or payroll or checking accounts or anything.

Q. Anyway you had enough information it be deemed done by Construction Materials but you didn't want to pay the money to Pioneer Constructors, isn't that correct?

A. The terms of the agreement we had, we just

(Testimony of Harold Ashton.)

weren't going to pay any money to anybody until this thing was settled.

Q. Did Pioneer submit any bills to you during that time for any of the work done through November or December on any claims?

A. I don't believe they did.

Q. Do you remember during the early part of February, 1957 having a telephone conversation with Mr. Taylor of Hartford?

A. I recall such a conversation.

Q. Do you recall making the statement during that conversation that Pioneer Constructors' contract had terminated on the 31st and Construction Materials had been on since then [91] and there had been no claims filed under the Miller Act?

Mr. Thompson: I am going to object to that as far as Armeo is concerned as hearsay.

The Court: He may answer the question. It isn't binding on Armeo.

Mr. Thompson: Then I have no objection.

Mr. Johnson: Do you want the question repeated?

The Witness: Yes.

(The last question read by the reporter.)

Mr. Catlin: Before he answers, to review your Honor's ruling, I am wondering which case we are in now. If it is not going in on either Apache or Armeo, it is apparently going into the third facet of the case between Hartford and Ashton-Mardian.

Mr. Johnson: If your Honor please, I will explain that it is strictly cross examination on Apache

(Testimony of Harold Ashton.)

and Armco for this reason: The witness has given considerable evidence as to what the relationship was between these parties on October 31st and the first party of January. I can introduce this statement as a relationship of what this witness considered this relationship to be which has been gone into.

Mr. Thompson: I don't think that conversation with the Hartford man should be binding on Armco.

Mr. Johnson: It is binding on the witness.

The Court: I have permitted him to answer. What date [92] is this conversation?

Mr. Johnson: It was during the first week in February. I don't have the exact date.

The Witness: I don't recall the conversation, but under the circumstances I don't see any reason I wouldn't have made such a statement. I might and might not have. I don't recall the conversation that precisely.

Q. (By Mr. Johnson): It is possible you made such a statement?

A. I think it is possible.

Q. Or substantially such a statement?

A. I could have very easily made such a statement. I don't know what difference it made to the Hartford. They dated the bond on the 1st of November. I don't know why I would want to be concealing such information.

Mr. Johnson: I move the last answer be stricken as not responsive.

The Court: It may stand.

(Testimony of Harold Ashton.)

Mr. Johnson: I believe that is all.

Cross Examination

Q. (By Mr. Fickett): Mr. Ashton, you said that it was the latter part of November, 1956 when you conversed with Joe Skorpick and Tom Moore, they were then the president and vice president of [93] Pioneer Constructors. They didn't make any such statement to you during that conversation, did they?

A. No. I don't think anyone asked me if they did.

Q. The only thing that you base that on is that they were the president and vice president of that corporation when the contract was signed and you never received any information to the contrary? That is all you base it on, isn't that right?

A. I think that is all I could base it on.

Mr. Fickett: That is all.

Direct Examination

Q. (By Mr. Catlin): There is only one thing I would like to ask Mr. Ashton and I would like purely for clarification, I am not sure there is a misapprehension among attorneys here just how this type of contract works or not. Mr. Ashton, the fact that the contract as drawn with Pioneer, I am referring to Plaintiff Armco's Exhibit No. 6, has the figure \$401,217.83. Does that have any relationship as to the actual amount of money that might be paid under this particular contract except for the fact that—

(Testimony of Harold Ashton.)

A. Had they completed the work, that would have been the amount of money they would have been paid. [94]

Q. With the exact amount?

A. With the exact amount of units.

Q. Of units? A. Yes.

Q. But the units vary on this contract, do they not? A. Yes.

Q. They could have conceivably been paid \$500,000 or \$300,000 under this same contract, depending on the difference in the units?

A. They could have. It is rare it would vary that much, but this is not a specific lump sum amount.

Q. This is not a lump sum contract; neither one are lump sum contracts? A. No.

Mr. Catlin: No further questions at this time. I reserve the right to call Mr. Ashton on direct examination again if necessary.

The Court: You may step down, Mr. Ashton.

(Witness excused.)

Mr. Catlin: May I ask the Court and the other attorneys: Mr. Ashton, it is imperative for him to be in Gila Bend tomorrow. Whether they think they will want Mr. Ashton again tomorrow or not. I am asking your indulgence because it is vitally important Mr. Ashton be in Gila Bend [95] tomorrow. He can return on Thursday if you think it is going that long.

Mr. Carr: As far as we know now, we won't want him for any further questions.

Mr. Thompson: The same is true as far as Armco is concerned, as of the present time I know of no particular reason we should want to examine him further.

Mr. Johnson: Also true as far as we are concerned.

Mr. Fickett: True as far as we are concerned.

The Court: Will you need him, Mr. Catlin?

Mr. Catlin: I don't think so.

The Court: All right.

Mr. Catlin: He can be excused and he will not be in the courtroom tomorrow and if anybody needs him, he can return on request on Thursday.

Mr. Thompson: That is acceptable as far as I am concerned.

Mr. Carr: Acceptable.

The Court: Mr. Ashton is excused then. [96]

* * * * *

Mr. Thompson: At this time Plaintiff Armco rests, your Honor.

Mr. Carr: Is J. E. Skorpick in the courtroom?

(No response.)

Mr. Carr: Is Mr. Simmons in the courtroom?

The Court: Do you want to call Mr. Simmons?

Mr. Carr: Yes, your Honor. I will call Mr. Simmons.

MELVIN J. SIMMONS

called as a witness herein, having been first duly sworn to state the truth, the whole truth and nothing but the truth, testified on his oath as follows:

Direct Examination

Q. (By Mr. Carr): Your name is Melvin J. Simmons? A. Yes, sir.

Q. Where do you reside, Mr. Simmons?

A. 3338 North Chapel, Tucson, Arizona.

Q. You hold a position at this time with Construction Materials Company? A. Yes, sir.

Q. What position is that?

A. Office manager and secretary.

Q. Are you also the treasurer of the company?

A. Yes, sir.

Q. How long have you been office manager, secretary and treasurer of Construction Materials?

A. I don't recall the date, sometime in '55, I believe.

Q. For several years then? [103]

A. Yes, sir.

Q. Prior to March 30, 1956? A. Yes, sir.

Q. Are you now an officer of Pioneer Constructors? A. No, sir.

Q. On March 30, 1956 were you an officer of Pioneer Constructors? A. March 30, 1956?

Q. Yes.

A. I don't believe so, no. Wait a minute. 1956?

Q. '56. A. Yes, I believe I was.

Q. What was your position? Were you officer of the corporation?

(Testimony of Melvin J. Simmons.)

A. Assistant secretary, but the period of time I don't know offhand.

Q. When did they terminate your position as assistant secretary of Pioneer?

A. As far as I know, it terminated when I went off the payroll sometime in, I believe in October or the first part of October, I believe.

Q. 1956? A. Yes, sir.

Q. Did you resign as an officer of the corporation?

A. Yes. Not in writing but by conversation, yes, sir. [104]

Q. On March 30, 1956 were you also assistant treasurer of Pioneer? A. No.

Q. On that date were you an office manager for Pioneer? A. Yes.

Q. On that date did Pioneer and Construction Materials occupy the same offices?

A. They did.

Q. Who were the other officers of Pioneer?

A. Other than J. E. Skorpick and T. E. Moore, I think William Nanini. I believe William Nanini was the other officer.

Q. What was Mr. Skorpick's position?

A. At that time he was president.

Q. And Mr. Moore's?

A. Vice president.

Q. Did they hold positions as officers with Construction Materials? A. They did.

Q. What were those positions?

A. President and vice president.

(Testimony of Melvin J. Simmons.)

Q. Skorpick was president and Mr. Moore was vice president? A. Yes, sir.

Q. Pioneer and Construction Materials occupied the same offices on March 30, '56, did they not?

A. Yes, sir.

Q. And had the same addresses as a result?

A. I believe they used a different box number, but it was the same address.

Q. Did they have the same telephone numbers?

A. Yes, sir.

Q. You had, in fact, a switchboard serving all of the two companies and all employees in those companies there? A. That's right.

Q. Did that situation exist as to the same offices and same telephone until November 1, 1956?

A. Yes. They had the same office and same telephone was used I believe on November 1, or October 31 I should say.

Q. Did it continue after that period?

A. Some of Pioneer's stuff remained in the building, yes, but Pioneer did not do any work after October 31st.

Q. After October 31, 1956, did you receive and open the mail addressed to Pioneer Constructors?

A. I don't recall whether I did or the girl that they sent in from Chicago did. I believe the one they sent in from Chicago opened the Pioneer mail.

Q. It was shown to you?

A. I believe it passed over my desk, yes.

Q. That condition continued until after March 12, 1957, did it not? [106]

(Testimony of Melvin J. Simmons.)

A. I do not know what date, how long it continued.

Q. You just stated that after November 1 or October 31, 1956 the mail addressed to Pioneer was opened by you or the office girl and passed across your desk?

A. I say I may have seen it but I did not open the mail, as far as I know.

Q. But you saw the mail?

A. Yes. I believe I saw it.

Q. And the girl in the office opened it?

A. That's right.

Q. How long did that practice continue?

A. That I do not know just how long it continued. It continued for a short time in which then I believe Mr. Catrin came in along with the girl he had sent in before and which he took care of all the mail that came in for Pioneer.

Q. You never saw it thereafter?

A. No, sir. Only in case it was lying on the desk there that they were occupying.

Q. Mr. Catrin and this girl you spoke of occupied the same office?

A. The same room in the building, put it that way. Not in the same office. There are different rooms in the building.

Q. Different rooms adjoining?

A. Yes, sir.

Q. Mr. Simmons, do you know Paul A. Swagerty? [107]

A. I do.

Q. Was he employed by Pioneer Constructors?

(Testimony of Melvin J. Simmons.)

A. He was.

Q. After Construction Materials took over the contract, he was employed by Construction Materials?

A. He was.

Q. He ordered the material for the Ajo job?

A. Ninety per cent of the time, yes.

Q. Specifically, did he order the material from Apache Powder Company after June 24, 1956?

A. I don't know the date, but I am sure he did most or all of the ordering from Apache Powder Company or anybody else.

Q. Up until October 31, 1956 did you receive so-called factory orders from Apache Powder Company for the orders put in by Mr. Swagerty?

A. I don't believe I follow just exactly what you mean by factory order.

Q. Did Mr. Swagerty give you any written memorandum of the orders he gave to Apache Powder Company?

A. I don't recall. We had a purchase order system that probably was in effect, but I don't recall.

Q. Did those Apache Powder Company factory orders mailed to Pioneer come across your desk as part of your duties as office manager?

A. Yes. They would come across my desk. [108]

Q. Was there a man by the name of West employed on the Ajo job?

A. Yes.

Q. What is his full name?

A. All I knew him by is W. D.

Q. W. D. West?

A. Yes, I think that is correct.

(Testimony of Melvin J. Simmons.)

Q. Was he employed by Pioneer Constructors before the change over on the subcontract?

A. Yes.

Q. At the time of the change over he was continued as an employee of Construction Materials?

A. Yes, sir.

Q. Do you know a man by the name of Thomas J. Dietzman? A. Yes, I knew Thomas.

Q. What was his position at the Ajo job?

A. It varied from grade foreman to equipment operator.

Q. Was he originally employed by Pioneer Constructors? A. Yes.

Q. Did he continue to work through at the time of the change over and as an employee of Construction Materials? A. I don't believe so.

Q. You believe his position terminated at what time, to the best of your recollection?

A. I have no records to show. I know from what I am [109] looking through, my records, he wasn't on Construction Materials payroll that I can see.

Q. Do you know a man by the name of H. Creswell? A. Yes.

Q. What position did he hold on the Ajo job?

A. He didn't hold any position on the Ajo job.

Q. Who was he employed by?

A. Construction Materials Company.

Q. What was his position with Construction Materials?

A. As manager in charge of the ready-mix department.

(Testimony of Melvin J. Simmons.)

Q. Was he an officer of Pioneer Constructors on August 29th, 1956? A. No.

Q. L. O. Hill? A. I don't recall.

Q. Leo Mather or Trotter?

A. I don't recall that name. They must be laborers.

Q. L. L. Witt?

A. L. L. Witt, I don't know his capacity, I do know he was on the job.

Q. Who was he first employed by?

A. I don't know if he worked for Pioneer or not, but I have seen him on Construction Materials records.

Q. Bill Knight?

A. I remember all right. Bill Knight was working with [110] Mr. West.

Q. He was originally employed by Pioneer Constructors? A. Yes. I think he was.

Q. Then continued on the job after the change over of Construction Materials?

A. I don't know. I didn't notice his name.

Q. D. Taylor Wilkie, do you know him?

A. Yes, sir.

Q. What position did he hold?

A. I guess you would call him parts expeditor.

Q. Was he originally employed by Pioneer Constructors? A. Yes, sir.

Q. And carried over onto Construction Materials payroll?

A. I believe we had him on Construction Materials payroll for awhile.

(Testimony of Melvin J. Simmons.)

Q. Were you a stockholder of Pioneer Construction? A. No, sir.

Q. Are you now a stockholder of Construction Materials? A. No, sir.

Q. Have you ever been a stockholder of either company? A. No, sir.

Q. After October 31, 1956 did you act for and on behalf of Construction Materials in the same capacity that you had prior to that time?

A. Yes [321]

Mr. Carr: I believe that's all.

Cross Examination

Q. (By Mr. Thompson): Did I understand you correctly, did you state that you severed your connection with Pioneer Construction on or about the 1st of October, 1956?

A. I don't remember the exact date. It was in October that they took the books and everything, when they sent a girl in from Chicago.

Q. You were cut off Pioneer's payroll at that time, is that right?

A. I don't remember if I was cut off the payroll then or October 31st, I would have to check.

Q. It was during the month of October?

A. Yes, sir.

Mr. Thompson: That is all.

Cross Examination

Q. (By Mr. Collins): Mr. Simmons, you were subpoenaed here today to bring certain records?

(Testimony of Melvin J. Simmons.)

A. Yes, sir.

Q. I believe we asked for all the payroll records and vouchers of Construction Materials Company on the Ajo job for [112] the months of November and December of '56 and January of '57?

A. Yes, sir.

Q. Did you bring those with you?

A. Yes, sir.

Q. Were you ever actually, ever have occasion to actually be on the site of the so-called Ajo job?

A. Yes, I was there.

Q. At what times were you on that site?

A. I don't recall the exact dates. There were several times I was there. I know one time particular was I remember was around April 15th besides two or three other times before then.

Q. April 15th of what year? A. '57.

Q. Were you there on the Ajo job in any time during 1956? A. Twice.

Q. Do you know when, at what times those were?

A. No, I don't. One was September sometime.

Q. By which company were you employed at that time? A. Pioneer Constructors.

Q. What was the other time you were there?

A. I went over twice, I believe it was. I was there once in January I believe and April.

Q. That was when you were an employee of what company? [113]

A. Construction Materials.

Q. Mr. Simmons, you have testified here I be-

(Testimony of Melvin J. Simmons.)

lieve that you were an employee of Pioneer Constructors up to a point in October? A. Yes.

Q. 1956, is that correct? A. Yes, sir.

Q. Who fired you?

A. I would say Mr. Nanini just said, "That was it, that was all."

Q. When were you first informed that you were no longer to be an employee of Pioneer Constructors?

A. Well, it was in October that they told me there would be no more payroll after October 31st on anyone.

Q. Who gave you instructions in your capacity as an employee of Construction Materials Company? A. Mr. Skorpick.

Q. Does that apply both before November 1st and during the period prior to November 1st and subsequent to November 1st also? A. Yes, sir.

Q. Did you prepare the payroll records and the other records of the Construction Materials Company pursuant to instructions from Mr. Skorpick?

A. Yes, sir. [114]

Q. When and by whom were you informed that Construction Materials was taking over the balance of the work at the Ajo job?

A. I don't know the exact date, but it was prior to November 1st.

Q. Were you present at any discussions between officers of the two corporations regarding the switch over? A. No, sir.

Q. What were you told regarding the switch

(Testimony of Melvin J. Simmons.)

over at the date you do not remember exactly and by whom?

A. I was told by Mr. Catrin that Pioneer payroll would cease as of October 31st and there would be no more payroll for Pioneer Constructors and I was told by Mr. Skorpick that we were going to carry on and take over this job.

Q. With regard to the individual employees on the Ajo job, were there any instructions given you as to what to do about them? A. No, sir.

Q. Then what did you do about the individual employees on the Ajo job who were employees of Pioneer at that point?

A. Those that Mr. Swagerty sent time tickets okayed by him, I paid them by Construction Materials check.

Q. In other words, there was a lag—what is the payroll period?

A. Every week. The first of the week and the end of the [115] week.

Q. In other words, there was a lag of only one week between the time that during which time you may or may not have known who the employees of Construction Materials were on the Ajo job?

A. That's right. It would have been less than that, because the time tickets sometimes came in in the middle of the week.

Mr. Catlin: May I ask your Honor for a suggestion, or would there be any objection to marking these as one exhibit, or how would be the best from the Court's point of view?

(Testimony of Melvin J. Simmons.)

Mr. Fickett: Can we stipulate as to the substance of them?

Mr. Thompson: What are they dealing with?

The Court: We will take the afternoon recess and perhaps you gentlemen can agree how you want to handle them.

(Afternoon recess.) [116]

(After Recess.)

Mr. Catlin: I think, your Honor, we can get by with just a few questions on my part.

MELVIN J. SIMMONS

previously called and sworn, resumed the stand and testified further as follows:

Cross Examination—(Continued)

Q. (By Mr. Catlin): Mr. Simmons, by whom was Paul Swagerty employed on the Ajo job on the week of November 4th and November 10th?

A. Construction Materials Company.

Q. Did he receive a check for that week's work?

A. He did.

Q. And the amount of the check?

A. The net amount of that check was \$132.70.

Q. On which bank was that check written and by whom was it signed?

A. It was written on the Southern Arizona Bank and Trust Company to the account of Construction Materials Company, Construction Materials Division, Check No. 1108, signed by J. E. Skorpick and T. E. Moore.

(Testimony of Melvin J. Simmons.)

Q. By whom was Mr. Paul Swagerty employed on the week [117] which encompasses the date of December 4, 1956?

A. Construction Materials. December 4th? That is December 4th?

Q. December 4th.

A. Construction Materials.

Q. Was Mr. Swagerty paid for his work during that particular week?

A. Yes, he was.

Q. By whom was he paid?

A. He was paid by Construction Materials Company, check No. 1735 in the amount of \$132.70 net drawn on the Southern Arizona Bank account of Construction Materials Company, Construction Division.

Q. Has Mr. Swagerty been an employee of Construction Materials Company from November 4th, 1956 until an arbitrary date which I will mention as, say, May 1, 1957? A. Yes.

Q. Was he paid for his labor during that period of time? A. Yes.

Q. By whom?

A. Construction Materials Company.

Q. Do you know whether or not—you can answer this yes or no—Mr. Swagerty was an employee of Pioneer Constructors at any time after November 4, 1956?

A. I am trying to think. Repeat that again.

Q. Do you know whether or not Mr. Swagerty

(Testimony of Melvin J. Simmons.)

was an employee of Pioneer Constructors at any time subsequent to November 4th, 1956?

A. Do I know whether he was?

Q. Yes.

A. Yes. I know whether he was or not.

Q. Was he an employee of Pioneer Constructors at any time after that date? A. No, sir.

Q. Do you know whether or not Mr. W. F. Sager was an employee of Construction Materials Company for the week of November 4th-November 10th, 1956?

A. I will have to take a minute to check. Yes, he was.

Q. Was he paid for his labor during that week?

A. Yes, sir.

Q. What was the amount of the check and the number of the check and the bank drawn?

A. The amount of the check was \$160.77 net, check No. 1164, drawn on the Southern Arizona Bank and Trust Company, Construction Materials, Construction Division Account.

Q. Was Mr. Sager an employee of the Construction Materials Company? A. Yes, sir.

Q. On the week which includes the date of December 17, 1956?

A. There must have been one of those that slipped out of [119] here. Yes, sir.

Q. Was he paid for his labor during that week?

A. He was.

Q. By what check and what bank?

A. Check No. 1999, amount \$146.85, drawn on

(Testimony of Melvin J. Simmons.)

the Southern Arizona Bank & Trust Company, Account Construction Materials, Construction Division.

Q. I ask you, Mr. Simmons, and answer this yes or no, whether you know if Mr. Sager at any time after November 4, 1956 was an employee of Pioneer Constructors? A. Yes, I know.

Q. Was he such an employee at any time after November 4, 1956? A. No.

Q. Were Mr. Swagerty and Mr. Sager both employees of Pioneer Constructors prior to November 4, 1956?

A. I know Mr. Swagerty was and I am pretty sure Mr. Sager was.

Q. Do you know whether or not Pioneer Constructors paid any of the payrolls that were incurred either by Construction Materials or Pioneer Constructors on the Ajo job after the 1st day of November, 1956? I beg your pardon, strike that and correct it to the 4th day of November, 1956.

A. Pioneer Constructors did not pay any of the payroll on the Ajo job after November 4, 1956.

Q. Who in the Pioneer Constructors organization, of which I believe you were an assistant secretary, paid the payrolls, signed the payrolls for the month of October, 1956?

A. Well, October, '56, the payrolls were probably signed by J. E. Skorpick and T. E. Moore and might have been some signed by myself during that month.

(Testimony of Melvin J. Simmons.)

Q. Were you on the bank account as a signatory of Pioneer Constructors? A. Yes, sir.

Q. Up to what point?

A. I believe it was up until October 31st.

Q. Were you removed from the signature card from the bank at that time on Pioneer Constructors? A. Yes, sir.

Q. You have testified that you were instructed, I believe, by Mr. Skorpick that Construction Materials Company was to pick up the payrolls on the Ajo job effective on November 4th, is that correct?

A. Yes, sir.

Q. Was any explanation given to you at that time by Mr. Skorpick for this change?

A. The only explanation given to me was that Pioneer Constructors was ceasing operation.

Q. Do you have any way of pinpointing the date of those instructions to you? [121]

A. No. I know for a positive fact they would have been before November 4th, but as to the exact date, I don't know.

Q. As a matter of practice, when are the pay checks themselves prepared—when were they prepared during the week?

A. They are started on Saturday following the—which is the last day of the week.

Q. When are they delivered to the employees?

A. Wednesday of the following week.

Q. Were the pay checks delivered to the employees for the work of the week of November 4th, November 10th, in accordance with that procedure?

(Testimony of Melvin J. Simmons.)

A. Yes, sir.

Q. I believe you stated you were the office manager for Construction Materials and previously thereto the office *manage* for Pioneer, is that correct?

A. Yes, sir.

Q. As far as your records and your operations were concerned as office manager, do I understand that Construction Materials was actually on the ground and on the job at Ajo starting with the week starting November 4th, 1956?

A. Yes, sir.

Mr. Thompson: Is that as to office records of Construction Materials?

Mr. Catlin: As far as his records are concerned. [122]

Mr. Thompson: All right.

The Witness: Yes, sir.

Q. (By Mr. Catlin): As far as your records are concerned, did they continue on that job until the finish of the work?

A. They did.

Q. Do you of your own knowledge know of any employee of Pioneer Constructors who was on the job at Ajo after November 4, 1956?

A. I know of none.

Q. Did you have anything to do with the change over from Pioneer to Construction Materials on the Ajo job so far as the relationship between either of those corporations and the Ashton-Mardian Company was concerned?

A. Not actually, only just from bookkeeping and accounting records.

(Testimony of Melvin J. Simmons.)

Q. While I think of it, is it your duty as office manager of these corporations to file the certified payrolls with the Government? A. Yes.

Q. Was that done? A. Yes, sir.

Q. What was the last payroll which was certified to the Government as being that of Pioneer Constructors? A. October 31st.

Q. As far as you know, all those certified payrolls have [123] been filed in accordance with the requirements of the Government, is that correct?

A. That is right.

Q. Did you, Mr. Simmons, have anything to do with the computation of the amount of work remaining to be done which was the basis of the contract with Construction Materials Company?

A. No, sir.

Q. Do you know by whom that computation was done?

A. It was done by engineers of Ashton-Mardian and from the Ajo job, the way I understood it, and the Corps of Engineers man.

Q. By what representative of Construction Materials Company, if you know?

A. Mr. Swagerty, I imagine.

Mr. Catlin: No further questions at this time.

Cross Examination

Q. (By Mr. Johnson): Mr. Simmons, do you recall having any contact, conversations or dealings of any kind, with any representatives of the Apache Powder Company since November 1, 1956?

(Testimony of Melvin J. Simmons.)

A. Yes.

Q. Can you tell us what those dealings or conversations consisted of? [124]

A. It has been quite a little while. Some I have forgotten. Some I remember now. The one that I remember was with Mr. Sturm I believe it is.

Q. Mr. Sturm is with Armco?

A. You mean Apache Powder?

Q. Apache Powder is the question this time. I will ask about Armco later.

A. There were several times I called Apache Powder. I don't remember them all. One time in January I called in regards to the billing that had been made to us.

Q. To refresh your memory, would that have been on or about the 10th of December, 1956, I believe you testified in your deposition?

A. I believe that was about the date, yes. It would have been around the time we would have been paying our bills. That would be around December 10th.

Q. That was a telephone conversation?

A. Yes.

Q. Did you call them or did they call you?

A. I called them.

Q. Was anyone present with you at the time you called? A. No, sir.

Q. Who did you talk to at Apache?

A. I don't remember who I talked to. I talked to a man after—a girl answering, but I don't remember who I talked [125] to.

(Testimony of Melvin J. Simmons.)

Q. Who did you ask for when the girl answered?

A. I asked for the bookkeeping or accounting department.

Q. Please relate the substance of that conversation.

A. I explained to them that the powder being sent to the Ajo job should have been billed to Construction Materials because they were doing the work. I would appreciate if they would bill it to Construction Materials. And as I recall, he told me, "Pay these by invoice and get it straightened out," and that is all I remember of the conversation.

Q. Did you pay it by invoice after that?

A. Yes, sir.

Q. You said you had several conversations with Apache. Could you tell us about some of the others, about the others?

A. I don't recall specifically the others. There probably were times I called them or called Swagerty to order materials. There were probably times I called them to get prices on other jobs but specifically I can't recall the times.

Q. Do you recall any other conversation with them which might have been mentioned whether or not it was Construction Materials or Pioneer who might have been on the job other than this one conversation on December 10th?

A. No, sir, I do not.

Q. Did you at any time to your best recollec-

(Testimony of Melvin J. Simmons.)

tion ever represent to anyone connected with Apache Powder or to anyone [126] else that Construction Materials Company was a division of Pioneer Constructors, or words to that effect?

A. I did not, no.

Mr. Johnson: May these be marked for identification?

(Hartford's Exhibits B, C, D and E marked for identification.)

Q. (By Mr. Johnson): I will now hand you a document marked Hartford Exhibit B for identification, which consists of a statement by Apache Powder Company and several invoices by Apache, together with some auto-truck bills of lading, and I will ask you if that is the statement and invoice to which you had reference when you were telephoning, when you talked to Apache Powder Company representative in this telephone conversation on or about the 10th you told us about?

A. Yes, sir.

(Hartford's Exhibits F, G, H and I marked for identification.)

Q. (By Mr. Johnson): I will now hand you Hartford's Exhibit F for identification and ask you whether or not that is a true copy of the check and voucher attached thereto by which you paid that invoice which is in another exhibit?

A. Yes, it is.

Q. Do you have the original cancelled check in your possession?

A. Yes. [127]

(Testimony of Melvin J. Simmons.)

Mr. Johnson: I offer in evidence Exhibit B and F.

The Court: Weren't those stipulated on the pre-trial, Mr. Johnson?

Mr. Johnson: I believe, your Honor, they were stipulated that all these could be admitted except one which counsel said wasn't a true copy. That is Exhibit G, and counsel has furnished me with Exhibit I which he has stated is a true copy of Exhibit G.

The Court: If I can see the backs of them I can tell you which ones were stipulated on the pre-trial.

Mr. Fickett: Can't you offer them all at one time to save some time, Mr. Johnson? There is no question as far as I am concerned.

Mr. Carr: No objection to Hartford's B and F.

The Court: All of these were stipulated on pre-trial that they might be received.

Mr. Johnson: I believe all but one, your Honor. One little red exhibit, I believe H, was not.

The Court: These are E, F and G. They were marked on the pre-trial E, F and G.

Mr. Johnson: The one marked now for identification as G, Mr. Carr advised me is not a correct copy and he did furnish me with Exhibit I which he said was a correct copy of the voucher attached to the check.

The Court: You are not offering G. [128]

Mr. Johnson: I want to offer I in lieu of G for that reason. I do want to offer the part of G

(Testimony of Melvin J. Simmons.)

which purports to be a copy of the check. The check I understand is a true——

The Court: If you will give me those others also. All exhibits marked through I for identification will be received. Those are Hartford's exhibits.

(Hartford's Exhibits B, C, D, E, F, G, H and I marked in evidence.)

Mr. Johnson: I believe without taking the time to question the witness in detail as to each one, may it be stipulated that the checks and vouchers which have been introduced in evidence are in payment of the invoices which are attached to the statements and so show on the vouchers attached to the checks? I believe they speak for themselves.

Mr. Carr: We won't stipulate.

Q. (By Mr. Johnson): I believe you have testified that the check and voucher attached thereto which were introduced as Exhibit F are in payment of the statement attached to Exhibit B?

A. Yes. That is the one.

Q. Do you have a check in your possession dated February 12th payable to Apache Powder?

A. Yes.

Q. We have here Exhibit G which purports to be a copy of the check of that date and a copy of a voucher attached [129] thereto which counsel for Apache has told me is not a true copy of the voucher. He states that Exhibit I is a correct copy of the voucher. I will ask you if the check attached to G is a true copy of the check, the original cancelled check?

(Testimony of Melvin J. Simmons.)

A. Yes. This is a true copy of the check.

Q. I will refer you now to Exhibit C and D which consist of statements together with vouchers and ask you whether or not the check which you have been referring is in payment of all or part of those?

A. This portion here is in payment of that.

Q. The check on Exhibit G is in payment of the vouchers on Exhibit C, is that right?

A. Yes.

Q. I will now hand you Exhibit E and H which are again copies of checks and vouchers and I ask you whether or not that copy of the check is a true copy of the cancelled check in your possession and whether or not that check pays the invoices?

A. Yes, it is; it pays also these invoices which you didn't mention.

Q. Invoices attached to D. Calling your attention to the vouchers which were attached to the checks, it states that it is in payment of the following invoices which you list the invoice numbers. Those invoice numbers are invoices [130] attached to the Exhibits of the statements?

A. Yes.

Q. I notice on each occasion the check paid that particular group of invoices for those amounts and did not pay any of the old balance which apparently had been charged to some earlier date, is that correct?

A. That's right.

Q. What was the reason for payment in that manner?

(Testimony of Melvin J. Simmons.)

A. As I stated, these particular invoices should have been billed to Construction Materials and that is the reason I paid them by invoice in order to clarify that particular point.

Q. The checks which you paid were signed Construction Materials? A. Yes.

Q. As on the invoices? A. Yes.

Q. Who was the individual who actually signed the originals of the checks?

A. J. E. Skorpick and T. E. Moore and two cases, J. E. Skorpick in the other one.

Q. In each case the check is headed Construction Materials Company, Construction Division, giving the address, signed Construction Materials Company by the individuals named.

Do you recall on or about December 10, 1956 a telephone conversation with Mr. Sturm of Armco Drainage Company? [131]

A. I don't recall the date, but I remember now the conversation with Mr. Sturm.

Q. If Mr. Sturm testified under oath and made affidavit it was made on December 10th, would you accept that date as approximately correct?

A. As far as I know, yes; I don't recall the date because I didn't keep a record of it.

Q. Do you recall the substance of that conversation?

A. Yes. It was shortly after Mr. Swagerty called me about being short, the exact material, I don't know what it was. It was something they were short on the job and asked me to get hold

(Testimony of Melvin J. Simmons.)

of Armco and order it, and in that time I think Mr. Sturm called me on something else. I don't recall what it was at the time.

Q. To refresh your memory, could it have been three rods and lugs for some end sections?

A. I had bolts in my mind.

Q. Go ahead and relate the conversation.

A. As I recall, he said he would have them shipped down and I told him Construction Materials was installing them and he said, "This is part of the original order of Pioneer Constructors so we will just ship them that way. There will be no charge on them."

Q. You are definitely testifying you advised him Construction Materials was on the job on December 10th, is that [132] correct?

A. That was my understanding, yes, sir.

Q. Do you recall whether or not you told him what date the change had taken place?

A. I don't recall that, no, sir.

Q. Did you have any conversation with any other representative of Armco in regard to this matter?

A. Yes. There were times which—you mean in regard to Ajo?

Q. Yes.

A. Another time we ordered some pipe from Armco for the Ajo job.

Q. When was that?

A. The first part of March I think. March 5th approximately.

(Testimony of Melvin J. Simmons.)

Q. March 5th you ordered some material, some construction materials for the Ajo job, is that right? A. Yes.

Q. Do you recall from whom you ordered that material?

A. They were ordered from the Phoenix office, Mr. Sturm.

Q. Was that order made in the name of Construction Materials or Pioneer Constructors?

A. In the name of Construction Materials.

Q. Do you have any written records in regard to that order of the 5th you have been telling us about? [133]

(No audible answer.)

(Hartford's Exhibit J marked for identification.)

Mr. Johnson: At this time we offer Hartford's Exhibit J for identification which is the "no charge invoice" in December which the witness is referring to. Possibly it is a duplication of one of Armco's offers. I am not sure.

Mr. Thompson: No objection.

The Court: It may be received as Hartford's Exhibit J in evidence.

(Hartford's Exhibit J marked in evidence.)

(Hartford's Exhibit K marked for identification.)

Q. (By Mr. Johnson): I hand you Hartford's K for identification and tell me what that is?

A. That is an invoice for an order placed on 3/5, shipped 3/7, invoice dated 3/8, to Construc-

(Testimony of Melvin J. Simmons.)

tion Materials, shipped to the Ajo job in care of Mr. Swagerty. It is for one——

Mr. Thompson: That hasn't been offered in evidence.

Mr. Johnson: I just wanted to know what it is.

Q. (By Mr. Johnson): This item reading from the invoice—— A. It is a duplicate.

Q. Duplicate copies of the same invoice and the third is an acknowledgment? A. Yes.

Mr. Johnson: I offer in evidence Exhibit K at this time. I state at this time the purpose for the offer, your [134] Honor. It involved material which is not involved in this lawsuit. However, it is offered for impeachment purposes for the reason Mr. Sturm testified positively he did not know until March 11th at the time of this conversation with Mr. Gibson that there had been any change on the job, that Construction Materials was on the job, whereas this invoice shows at least someone connected with Armeo knew on the 5th or the 6th that Construction Materials was out there.

Mr. Fickett: It is an Armeo invoice, isn't it?

Mr. Johnson: Yes.

Mr. Thompson: If the Court please, it is offered for impeachment purposes only. However, I believe Mr. Sturm testified these invoices were sent out of the San Francisco office of Berkeley, not from Tempe, and there is no way of showing whether or not he had knowledge of the invoices at this particular time.

The Court: Mr. Johnson, do you contend there

(Testimony of Melvin J. Simmons.)

is anything in the exhibit that shows Mr. Sturm had notice?

Mr. Johnson: The witness testified the order he thought was placed with Mr. Sturm, these invoices.

The Court: Let us get to that. That is the witness' testimony. What about the exhibit?

Mr. Johnson: I don't think the exhibits have Mr. Sturm's name on them at any point. They are on Armeo's form and show that Armeo had notice, whether Mr. Sturm did or not. [135]

The Court: You have offered them by way of impeachment of Mr. Sturm?

Mr. Johnson: Yes.

The Court: Unless they would serve to impeach him, the objection would be good.

Mr. Johnson: I will offer them then for the further purpose of showing that Armeo Company had notice at an earlier date than the notice Mr. Sturm admits he received.

Mr. Thompson: I fail to see the materiality of that actually, your Honor.

The Court: May I see the exhibit.

Mr. Johnson: I think Mr. Sturm testified his first knowledge was on the 11th of March. This exhibit shows that somewhere in the Armeo organization, at least, a notice came to somebody before that date. I believe it is permissible to show notice that tends to corroborate Mr. Simmons' statement that at an earlier date in December he told Mr. Sturm that Construction Materials was there.

Mr. Thompson: It simply shows that if any-

(Testimony of Melvin J. Simmons.)

thing, there was an order made by Construction Materials Company by Mr. Swagerty.

The Court: I am going to let it in. I don't think it is going to make a bit of difference to me. As I see it, the question between Armco and Ashton and Hartford and the others here is whether the notice was given within ninety [136] days. I don't think as far as that particular facet of the case is concerned a changeover from Construction or from Pioneer to Construction has a great deal to do with it.

Mr. Johnson: Your Honor, it has something to do at this point, that Armco was relying on that December delivery to bring itself within the ninety days.

The Court: That is true, but according to the evidence so far, that December delivery was encompassed within the purchase order that was entered into in April and the Statute is that within ninety days from furnishing the last of material to the supplier or subcontractor.

Mr. Johnson: We contend it was furnished to a different subcontractor and Armco had notice it was.

The Court: It might be. I am only going on the evidence so far that a different sub took it and used it but it couldn't alter the fact as to where it was furnished, if it was actually furnished for Pioneer. This thing is a little bit confusing in that here are two people, Pioneer and Construction that are undertaking to make deals among

(Testimony of Melvin J. Simmons.)

themselves and actually it wasn't until January that the prime on the job said, "Okay, I will recognize Construction as a subcontractor." In the meantime the work goes along. The subcontract is pursued and if Construction used it, I don't see, even if they did use it under those circumstances, I don't see how you can say theirs wasn't furnished under the [137] original contract. But I will receive the exhibit. I don't think it makes enough difference to fuss about.

(Hartford's Exhibit K received in evidence.)

Q. (By Mr. Johnson): I take it you don't recall any conversations with anybody connected with either Apache or Armco subsequent to November 1, 1956 other than those we have gone into here today, is that correct?

A. No conversation, no, that I can remember.

Mr. Johnson: I believe that is all.

Mr. Fickett: No questions.

Redirect Examination

Q. (By Mr. Carr): I will hand you Hartford's Exhibit E, Mr. Simmons, and ask you whether those are the invoices from Apache Powder Company to the Pioneer Constructors dates in the month of November, 1956? A. Yes.

Q. Hartford's C are Apache invoices and Pioneer for the month of December, '56?

A. That's right.

Q. Hartford's D are Apache Powder invoices to Pioneer issued in the month of January?

(Testimony of Melvin J. Simmons.)

A. That is correct.

Q. And Hartford's E are Apache Powder Company invoices, [138] which invoices were issued on March 12, 1957? A. That's right.

Q. How did these come into your hands, Mr. Simmons?

A. I imagine they were given to me by either Mr. Catrin or his girl.

Q. Don't all these documents here refresh your recollection? Can't you tell us directly and positively how you came into possession of them?

A. No. I know that the stuff that came into Pioneer like this which was in error should have been Construction Materials they turned over to me. I know that for a positive fact, but to say just how these came into my possession other than one of them gave them to me, that is the only way I would know I got them, except the one in November, I may have opened the one in November myself.

Q. They came to you as they were received by Pioneer, not in bunches by the month?

A. No. They came to me as they were received.

Q. How long did Pioneer Constructors keep someone there to receive mail and take care of the Pioneer business?

A. I don't recall the date, but I think it was in the latter part of January or February. It may have been later than that, but I don't recall.

Q. After January or February of 1957, Con-

(Testimony of Melvin J. Simmons.)

struction Materials got the Pioneer mail, is that true? [139]

A. No. I believe it went to Fickett & Dunipace and they forwarded anything on it to us.

Q. Fickett & Dunipace are the attorneys in this case for Pioneer?

A. That is my understanding, yes, sir.

Q. You knew that at the time?

A. Yes, sir.

Q. On December 10, 1956 according to your previous testimony you called up Apache Powder Company in Benson?

A. On or about December 10th, yes.

Q. And you asked for the bookkeeping or the accounting department?

A. I believe that is the way I stated it, yes, sir.

Q. In one of your statements in the deposition, Mr. Simmons, that you gave you stated that you asked for the purchasing department. You were in error at that time?

A. No. As I stated, I don't know whether I called for purchasing. If I said purchasing I am referring to the accounting department, but that is what I meant anyway. I don't know if I said purchasing, but I meant accounting department or bookkeeping department. Someone handling the account.

Q. Did you ask the persons' name?

A. No, sir, I did not.

Q. Did you ask what his capacity was with the company?

A. No, sir, I did not. [140]

(Testimony of Melvin J. Simmons.)

Q. Was this a matter of importance to Construction Materials Company to have invoices on the Ajo job directed to them instead of Pioneer?

A. I didn't get that.

(Last question read by the reporter)

A. Yes, I believe it was.

Q. Why didn't you write a letter?

A. I don't know. I just didn't.

Q. Did you ever write a letter to Apache Powder Company?

A. I did not, except in regard to the—later, after all this had transpired in regard to the powder. I believe it was removed from the job.

Q. What was the date of that letter?

A. I don't know if I wrote it. Mr. Yeager wrote that letter August 3rd, I believe.

Q. August 3rd, 1957?

A. I wrote one August 3rd, yes. August 3rd I wrote one but August 1st Mr. Yeager wrote one.

Q. Your first communication with Apache Powder was October 3rd, 1957? A. In writing?

Q. By letter. A. Yes.

Q. Why didn't you ascertain the name of the person you were talking to? [141]

A. Mainly because I didn't think about it. I think I was interested in getting it changed and mentioned it to him and thinking it would be taken care of.

Q. Why didn't you ascertain what job he held with the company?

(Testimony of Melvin J. Simmons.)

A. I never made it a point to do that, and I guess maybe it is negligence on my part, but I didn't do it.

Q. After February, 1957 I believe you stated you received the invoices from Fickett & Dunipace?

A. I think it was about that time. I am not sure.

Q. Did you also receive the factory orders, copies of the factory orders?

A. They were probably on the job. I probably didn't see those. You mean the shipped bills of lading?

Q. No, the Apache Powder Company factory orders, copies of which were sent to Pioneer Constructors.

A. I don't recall what they are. I may and I may have received some, but I don't recall; if I did, they are with these things. That is everything I have.

Q. After February, 1957 did you receive the monthly statements from Apache Powder addressed to Pioneer?

A. Not that I know of. If they got in our possession they were forwarded to Fickett & Dunipace. It may have been March, but it was around that time.

Mr. Carr: That is all. [142]

Mr. Thompson: No questions, your Honor.

Mr. Johnson: That is all.

Mr. Carr: May I ask a couple more questions?

(Testimony of Melvin J. Simmons.)

Further Redirect Examination

Q. (By Mr. Carr): Are you an accountant by profession, Mr. Simmons? A. Yes.

Q. How long have you been such an accountant?

A. I imagine you can classify me in that classification since 1945.

Q. Were the invoices from Apache Powder directed to Pioneer after November 1, 1956 returned for correction? A. No, sir.

Q. Why not?

A. Because I was instructed by one of their men to pay them by invoice and that is the way I did it and I figured that was sufficient.

Q. Yet you don't know who this man was or his capacity with Apache? A. No, sir, I don't.

Q. When you received the monthly statements from Apache Powder Company directed to Pioneer Constructors, why didn't you return those for correction or recheck them?

A. I saw no reason to. We were paying the bills that [143] came to Construction Materials, and as far as the balance that was carried forward, I assumed it would be correct. I had no way of checking.

Q. So your only communication in all of these transactions subsequent to November 1, '56 was in regard to the invoices, factory orders and monthly statements, was your letter of October 3rd, 1957 returning one of the monthly statements?

A. Yes. At that time I got tired of the post

(Testimony of Melvin J. Simmons.)

office putting them in my box instead of sending them to Fickett & Dunipace.

(Plaintiff Apache's Exhibit 2 marked for identification.)

Q. (By Mr. Carr): I hand you Plaintiff Apache's Exhibit 2 for identification and ask you if that is your signature on that letter?

A. No, sir, it isn't.

Q. Whose signature is it?

A. I would say from looking at it that was the girl that typed it, June McClure.

Q. Her initials appear on the letter below?

A. Yes.

Q. Did you dictate the letter? A. Yes, sir.

Q. This letter is from Construction Materials Company to Apache Powder Company at Benson dated October 3, 1957, [144] returning monthly statement.

Mr. Johnson: I object at this time to his reading the exhibit until it is offered in evidence.

Mr. Carr: He didn't say he signed it.

Mr. Lester: He said he dictated it.

Q. (By Mr. Carr): It relates to monthly statement from Apache Powder dated September 30, 1957? A. Yes.

Mr. Carr: We offer it in evidence.

(Plaintiff Apache's Exhibit 2 marked in evidence)

Q. (By Mr. Carr): Then, Mr. Simmons, you never saw fit until October 3, 1957 to return any

(Testimony of Melvin J. Simmons.)

documents addressed to Pioneer Constructors from Apache Powder Company?

A. No, sir, because I didn't receive them all. Some went to Fickett & Dunipace and some got into our box by error of the Post Office.

Q. But the ones you received——

A. The ones I received I passed to Fickett & Dunipace, as I stated before.

The Court: Is there any objection to it?

Mr. Catlin: This letter is three months after this lawsuit was filed. We have no objection to it for what it is worth. What it is worth is the question in my mind.

The Court: It may be received.

Mr. Carr: That is all. [145]

Mr. Johnson: No more questions, your Honor. May Mr. Simmons be excused?

The Court: Any objections?

Mr. Thompson: Armeo has none.

Mr. Johnson: On one condition, I will want to reserve the right if necessary under the Rules to adopt his testimony as part of mine in chief.

The Court: I understood it was stipulated that the testimony of all witnesses as far as material would be considered in both cases.

Mr. Johnson: All right.

Mr. Carr: We have no objection to his being excused subject to call if at all necessary.

Mr. Johnson: You will be available in town?

The Witness: I will be in town.

(Witness excused)

ROBERT L. HENDERSON

called as a witness herein, having been first duly sworn to state the truth, the whole truth and nothing but the truth, testified on his oath as follows:

Direct Examination

Q. (By Mr. Carr): What is your name? [146]

A. R. L. Henderson.

Q. Where do you reside?

A. In Benson, Arizona.

Q. Do you hold any position with Apache Powder Company?

A. Yes, sir.

Q. What is that position?

A. General manager.

Q. What are the duties of general manager?

A. Well, direction of the Apache Powder Company at Benson.

Q. You are the active head of the operations for the company?

A. Yes, sir.

Q. Prior to March, 1956, did you have any business relations, did Apache Powder Company have any relations with Pioneer Constructors?

A. Prior to what date?

Q. March, 1956.

A. March, 1956, yes, I believe we did.

Q. Were you supplying materials to them?

A. Yes.

Q. On what jobs, that you recall?

A. Well, we supplied explosives and blasting supplies to Pioneer Constructors on a highway job on Highway 80 near Bisbee near the Mule Pass in

(Testimony of Robert L. Henderson.)

Bisbee and also supplied materials [147] to Pioneer Constructors at a quarry near Tucson.

Q. Was that arrangement on an open account with them? A. Yes, sir.

Q. Had you prior to that time obtained Dun & Bradstreet reports on Pioneer Constructors?

A. Yes.

Q. Were they favorable or unfavorable?

A. Favorable.

Q. Did the Apache Powder Company learn of the Government contract at Ajo awarded to the Mardian Construction Company? A. Yes.

Q. Did you ask any of your field agents to investigate? A. Yes.

Q. Did they contact Mardian Construction Company? A. Yes.

Q. What was the result?

A. Well, in connection with this Ajo job, one of our field men, according to our usual practice contacted the contractor Ashton-Mardian and was told——

Mr. Johnson: I object to any conversation being from a third person.

The Court: Objection sustained.

Q. (By Mr. Carr): Did an employee of your company subsequently contact Pioneer Constructors in connection with the furnishing of powder on this Ajo job? [148] A. Yes.

Q. Did the Apache Powder Company obtain the contract for the supply of explosives and blasting supplies under the Pioneer's subcontract?

(Testimony of Robert L. Henderson.)

A. Yes.

Q. Then thereafter did Apache Powder begin furnishing supplies to the Ajo job for Pioneer?

A. Yes.

Q. When was the first shipment of material, if you recall?

A. June 13, 1956.

Q. After that date did Apache Powder Company continue to supply material for the Ajo job?

A. Yes.

Q. When was the last date on which the material was supplied to the Ajo job?

A. March 12, 1957.

Q. Was this material delivered on the job?

A. Yes.

Q. In what manner?

A. By truck, by contract carrier with whom we have do work for us.

Q. In connection with these shipments on the Ajo job, were orders periodically received from Pioneer Constructors?

A. Yes. [149]

Q. As a matter of bookkeeping and accounting practice, what was the first step taken by Apache Powder Company after receiving of an order?

A. After receipt of an order, the form of record and acknowledgment of the order, which we refer to as the factory order, is made.

Q. Is a copy of that factory order immediately sent to the customer?

A. Yes.

Mr. Carr: I ask that this group of documents be marked as one exhibit.

(Testimony of Robert L. Henderson.)

(Plaintiff Apache's Exhibit 3 marked for identification)

Q. (By Mr. Carr): Mr. Henderson, I hand you Exhibit 3 for identification and ask you what they are?

A. This is a factory order, this top one, and there are a number of those.

Q. Have you previously examined this group of documents? A. Yes, sir.

Q. State whether or not they cover all of the orders for material on the Ajo job from June 13, 1956 to March 12, '57?

A. It would be my—I would say it covers it all. It covers from June 13, 1956 to March 12, 1957.

Mr. Carr: We offer them in evidence.

The Court: We will recess at this time [150] until 9:30 in the morning. That will give you time to examine them.

In the meantime, they are marked for identification.

Recess until 9:30 tomorrow. [151]

(Whereupon a recess was taken until 9:30 A.M., March 5, 1958.)

March 5, 1958—9:30 o'clock A.M.

ROBERT L. HENDERSON

having been previously duly sworn, resumed the stand and testified further as follows:

Further Direct Examination

Mr. Carr: If the Court please, I would like to

(Testimony of Robert L. Henderson.)

ask a couple more preliminary questions of Mr. Henderson in regard to these factory orders.

Q. (By Mr. Carr): What are the pencilled notations attached to each of the factory orders, Mr. Henderson?

A. There is a pencilled notation here which is the instruction received in regard to the order, that is the amount and type of proceeds and some delivery instructions.

Q. That is the information received over the phone from which the order was made?

A. Yes, sir.

Q. There is another document called truck inspection report?

A. Yes, that is this one, one of the truck inspection reports which is made of the truck and equipment to see it is in good condition.

Q. Because you are handling explosives? [152]

A. That is right. We check it. It is very important.

Q. There is another document.

A. This is the bill of lading.

Q. That is just an office copy?

A. That is an office copy of the bill of lading.

Q. Are these factory orders as they now exist with the attachments in the form they are kept in your office?

A. That is right.

Mr. Carr: If the Court please, we again offer these factory orders for the purpose of putting in evidence here the orders for powder and blasting

(Testimony of Robert L. Henderson.)

supplies, for the reason that there are no written orders from the Pioneer Constructors in this case; and for the further reason that we wish to show that in all instances these were addressed to Pioneer Constructors and were never returned for correction or never rejected by the Pioneer Constructors.

There is one other point. There is a column here entitled "Code. Above as shipped and Code," and pencil notations. In this first instance it is June 13, factory order, and pencil notations made 28/56. What is that notation?

A. That notation refers to the date of manufacture.

Q. (By Mr. Carr): Of the powder? That was shipped at that time? A. Yes. [153]

Mr. Carr: We offer these in evidence.

Mr. Johnson: If the Court please, we object to the offer for the reason they are immaterial to any of the issues in the case. I think it is admitted the material was ordered and was delivered. The fact that Apache might have kept it in their records show it was an order by Pioneer is no proof whatever, especially in view of the fact that in their own amended complaint they state from and including November 1, 1956 to and including March 12, 1957 on open account with Pioneer Constructors at the special instance and request of Construction Materials Company they furnished the material. Now, they try to imply this material was furnished at the instance and request of Pioneer Constructors.

(Testimony of Robert L. Henderson.)

The Court: I think I can shorten this. We have in the issues outlined at the pre-trial the question of whether or not the prime and Hartford are estopped to claim that there was more than one subcontractor or that these goods were furnished to Pioneer; and this would bear on that, if it showed no more than that the goods were furnished by Apache in the belief that they were furnishing to Pioneer.

Mr. Carr: They show the specific dates of order and those become important in the case, your Honor.

The Court: They will be received.

(Plaintiff Apache's Exhibit 3 marked in evidence)

Q. (By Mr. Carr): Mr. Henderson, were [154] copies of these factory orders mailed to Pioneer Constructors at the time they were made out in your office? A. Yes.

Q. Were any of them returned for correction or rejection? A. No.

Q. Were the factory orders ever returned unopened or for any other reason? A. No.

Mr. Carr: Will you mark this group of documents, please.

(Plaintiff Apache's Exhibit 4 marked for identification)

Q. (By Mr. Carr): Mr. Henderson, I hand you Plaintiff Apache's Exhibit 4 for identification and ask you what these are?

(Testimony of Robert L. Henderson.)

A. This top sheet, aside from this adding machine tape, this top sheet is a copy of an invoice to Pioneer Constructors for delivery of material; the next sheet is a copy of the bill of lading, on which receipt of the material is acknowledged and signed for.

Q. Is that the original bill of lading?

A. Well, it is—it appears as if it could be an original. At any rate, it is the one which accompanied the load of explosives as it was delivered and signed by the one who received the shipment. Then of course they are duplicated [155] through there for the different shipments.

Q. In every instance these invoices—you have examined this file? A. Yes.

Q. In every instance are the invoices addressed to Pioneer Constructors? A. Yes.

Q. Were copies mailed to Pioneer Constructors? A. Yes.

Q. And in every instance was the bill of lading addressed to Pioneer Constructors at the Ajo job?

A. Yes, sir.

Q. And did Pioneer receive a copy of this bill of lading, and if so, how?

A. Well, they received the copy of the bill of lading with the shipment.

Q. Yes. At the time they receipted for it?

A. Yes.

Mr. Carr: We offer it in evidence.

Mr. Johnson: If the Court please, we object at

(Testimony of Robert L. Henderson.)

this time to the answers of the witness to the last question and ask it be stricken, on the ground he states that Pioneer received them. It is quite obvious this witness can't know whether they were received by Pioneer or Construction Materials. It is a conclusion of the witness. [156]

Mr. Carr: We will consent to that objection for the moment.

Mr. Catlin: Your Honor, may I ask one question on voir dire?

The Court: Yes.

Q. (By Mr. Catlin): Mr. Henderson, were any of these copies ever mailed to Ashton-Mardian or delivered to Ashton-Mardian to your knowledge?

A. Not to my knowledge.

Mr. Catlin: In view of your Honor's statement as to the reason why you accepted the factory orders, we object to these items insofar as they would be offered to show any basis of estoppel on the part of toward the prime contractor, Mr. Henderson stating that these were not mailed or delivered to the prime.

The Court: Mr. Catlin, estoppel isn't built out of any one factor. In other words, estoppel would begin with a good faith belief and act by Apache; then we would be concerned with whether or not Construction and Pioneer by their acts and conduct gave Apache the right to believe and act as they did. Finally we get to whether or not the prime by its conduct in the matter would be in a

(Testimony of Robert L. Henderson.)

position where it wouldn't be heard to say that Apache was dealing with Pioneer in this matter. In other words, here is one situation—it is only one facet of it—you have a prime that knows that work has [157] been going on since before November 1st, he knows when he is approached in late November that people are supplying materials out there to this job. He knows at that time the only subcontractor is Pioneer and that people dealing out there at that time, he must know, I say is charged with knowledge that people dealing with Pioneer is the sub. Then after the bond matter is straightened out, way into January of the next year they come back and attempt to postdate this job back to the first of November. I say that the prime at that time, from what I see here, should have known or was charged with knowledge that people were dealing on that job with Pioneer. No notice was given to them that Construction was stepping in. As a matter of fact, the record shows no notice to anybody except the prime and Pioneer and Construction, when everybody must have known that people continued to deal up into January with Construction as Pioneer.

Mr. Catlin: In other words, your Honor—this is a little bit off of the issue which I stood up on—you are saying to me that it is incumbent upon the prime to show knowledge on the part of either Armeo or Apache, or show information in their possession which will at least put us on even-

(Testimony of Robert L. Henderson.)

Stephen basis as to who they actually were dealing with, do I understand you correctly?

The Court: In essence, yes. I say that you may, although you never got any copies of these documents, you may [158] be in a position because of your failure, when there was a change, or at least when the change was contemplated, your failure to notify these people you should have known were dealing with Construction as Pioneer, your failure to do that may estop you. If, in fact, Apache was dealing with Construction as Pioneer it may estop you to claim they weren't dealing with Pioneer.

Mr. Catlin: But notice to either of the parties, if we can show notice to them—I am not trying to make an argument of the case here, but trying to get in my own mind, if we can show notice to Apache.

The Court: That is true, there could be no estoppel if they knew they were dealing with a different subcontractor.

Mr. Catlin: I renew my objection, knowing of course it will be overruled.

Mr. Johnson: I renew my objection on a different ground, to-wit, immateriality, does not prove or disprove the issues in the case.

The Court: May I see the exhibit, please?

Mr. Henderson, these are all records of the Apache Powder Company which you keep in the regular course of your business?

The Witness: Yes, sir.

(Testimony of Robert L. Henderson.)

Q. (By the Court): The records are made up and obtained in the course of your business and at or about the [159] time the transaction occurred?

A. Yes, sir.

The Court: They will be received.

(Plaintiff Apache's Exhibit 4 marked in evidence)

Q. (By Mr. Carr): Mr. Henderson, in all cases were these bills of lading prepared for receipt in the name of Pioneer Constructors? A. Yes, sir.

Q. Were they receipted for in the name of Pioneer Constructors by persons purporting to act for Pioneer?

Mr. Fickett: We object to that, if your Honor please, the document is in evidence, speaks for itself.

The Court: I think the record shows how they were signed.

Q. (By Mr. Carr): Mr. Henderson, there is evidence in this case which I believe you heard to the effect that the Construction Materials contract was not signed until January 8th, 1957. When was the last previous delivery shown by these invoices and bills of lading, prior to January 8th, 1957?

A. Just prior to January 8th, 1957?

Q. Yes. A. December 20th, 1956.

(Plaintiff Apache's Exhibit 5 marked for identification)

Q. (By Mr. Carr): Mr. Henderson, I hand you Plaintiff [160] Apache's Exhibit 5 for identification and ask you what they are.

(Testimony of Robert L. Henderson.)

A. These are copies of statements directed to Pioneer Constructors, monthly statements showing the status of the account, of our account with Pioneer Constructors.

Q. And the originals were mailed to Pioneer Constructors? A. Yes.

Q. As of the date of the individual statements?

A. Yes.

Q. And were any of these statements returned with the exception of the one of September 30, 1957?

A. With the exception of this statement of September 30th, 1957, no other statements were returned.

Mr. Carr: We offer these in evidence, if your Honor please.

Mr. Johnson: No objection, your Honor.

The Court: It may be received.

(Plaintiff Apache's Exhibit 5 marked in evidence)

Q. (By Mr. Carr): Mr. Henderson, do these statements to Pioneer Constructors include amounts relating to any other contract than the Ajo job?

A. Yes, they relate to our entire account with the Pioneer Constructors, which would have included other jobs to which we were supplying materials.

Q. And what were those jobs? [161]

A. A highway job on Route 80 near Bisbee, near the Mule Pass, and Tucson quarry of Pioneer Constructors to which we supplied materials.

(Testimony of Robert L. Henderson.)

Q. Do these statements also reflect payments made by Construction Materials on the Apache Powder account?

Mr. Johnson: If the Court please, we object to that form of the question in that it assumes facts not in evidence. The payments by Construction Materials were on the Apache Powder account. The witness has testified positively the payments by Construction Materials were on the Construction Materials account.

Mr. Carr: We believe the evidence of Mr. Simmons they were on the Apache Powder invoices satisfactorily supplies that information.

The Court: Let me have the question, Mr. Reporter.

(The last question was read)

Mr. Carr: May I make a correction, your Honor. The Apache Powder account with Pioneer.

Mr. Johnson: I was thinking about Pioneer.

The Court: He may answer whether it shows the payments by Construction Materials of statements addressed to Pioneer. Is that what you mean?

Mr. Carr: That would be sufficient, your Honor, for the present.

The Court: Do they show that? [162]

The Witness: Yes.

Q. (By Mr. Carr): Now, Mr. Henderson, in connection with deliveries of explosives and blasting supplies to the Ajo job, as evidenced by the factory orders, invoices, bills of lading and statements, was

(Testimony of Robert L. Henderson.)

it the belief of Apache Powder Company at all times up to March 19th, 1957 that these materials were being supplied to Pioneer Constructors under Pioneer Constructors subcontract of March 30, 1956? A. Yes.

Mr. Johnson: Let the record show an objection to that question on the ground the witness is competent to testify to his own belief but I doubt he can testify to the belief of other persons or belief of a company.

The Court: I will take the answer to be his understanding for Apache rather than any corporate belief.

Q. (By Mr. Carr): Did Apache Powder Company at any time loan to Pioneer Constructors a certain powder and cap magazine? A. Yes.

Q. When was that done?

A. That was done—well, it was done for at least two of the jobs for which we furnished powder.

Q. I am referring specifically to the Ajo job.

A. The Ajo job. Well, it was done prior to the start of the Ajo job, which would have been early in 1956.

Q. Yes. And is that the Apache Powder customary practice? [163]

A. Yes, it is the customary practice on these contract jobs.

Q. Had they previously loaned powder magazines to Pioneer on other jobs? A. Yes.

(Testimony of Robert L. Henderson.)

Q. What is the reason or purpose for supplying these magazines, Mr. Henderson?

A. Well, there might be different reasons. It is of mutual benefit. The magazines are loaned, I believe primarily to the contractor so there will be adequate and proper storage on the job for explosives. In addition to that, if we loan magazines with sufficient storage capacity it means we can deliver in larger quantities and it will be available to the contractor when he needs it.

Q. Just very briefly, of what are the magazines constructed?

A. The magazines are constructed of steel, they are welded steel construction, you might say in the form of a small building. It is portable. And they are adequately supplied with doors and provisions for locks and protection inside with wood where it is needed for proper storage of explosives.

Q. Did Pioneer return these magazines to Apache Powder Company, Pioneer Constructors, on or about November 1 or at any later date?

A. No.

Q. Mr. Henderson, you now know that there was a subcontract [164] to Pioneer Constructors and later a subcontract to Construction Materials?

A. Yes, sir.

Q. When did you first learn this?

A. When did I first learn——

Q. Of the termination of the Pioneer subcontract and the execution of the Construction Materials Contract?

(Testimony of Robert L. Henderson.)

A. In March, 1957, March 19th.

Q. 1957? A. 1957.

Q. And from what source?

A. From our attorneys, Evans, Kitchel & Jenckes in Phoenix—as a matter of fact, from Mr. Carr.

Q. Did you request your attorneys in Phoenix to make investigation in regard to the situation there at Ajo? A. Yes.

Q. Why did you do so?

A. Well, you might say there might have been different reasons. We have field men, we keep them in touch with the job and watching particularly when jobs are nearing completion.

Q. For what purpose?

A. So that we will be adequately protected in case there is any indebtedness on the job and we can take action if we need to.

Q. What action do you refer to? [165]

A. Well, as you understand, these contract jobs, including this one, are bonded, and we rely a great deal, principally I think, on the bonding, payment bond on the job to protect us in case the contractor doesn't pay.

Q. That is the payment bond of the prime contractor?

A. Yes. And it is necessary to take action at the appropriate time and so it is important to know when the job is finished and when we make the last deliveries of materials to the job. So that is one purpose of our fieldman. Of course, in general

(Testimony of Robert L. Henderson.)

he is to watch the progress of the job and personnel and equipment and so on, see how it is coming and do what servicing is required for the contractor. But by that practice we were aware this job was nearing completion, or least they were near the end of taking explosives in the early part of March. In addition to that it came to our attention reports of litigation against Pioneer Constructors in regard to payment or non-payment.

Q. From whom were these reports?

A. Well, we had a report from Dun & Bradstreet; and there were also statements in the press along about that time of this litigation.

Q. Just prior to your request of your attorneys to investigate?

A. Yes. That was early in March; and we went ahead and [166] reported to our attorneys and asked them to investigate and do what was necessary to protect our interests.

Q. As a result of this inquiry to your attorneys were you then informed that the Pioneer subcontract was terminated as of October 31, 1956, and the Construction Materials contract executed as of October 1, 1956?

A. That was the information——

Q. November 1.

A. November 1, 1956. That was the information that was given to me at that time.

Q. Was Apache Powder Company ever notified by Ashton-Mardian, Pioneer, Construction Materials, or anybody else of the termination of the

(Testimony of Robert L. Henderson.)

Pioneer subcontract and the execution of the Construction Materials contract and the fact that Construction Materials was proceeding with the job as an independent subcontractor? A. No.

Q. Did you obtain this information from any other source prior to March 19, 1957?

A. No.

Q. Now, after Apache Powder Company was notified—at this point, when was the last material supplied by Apache Powder Company on the Ajo job? A. March 12, 1957.

Q. And thereafter was a claim made to Mardian Construction [167] Company and Ashton Building Company and Ashton-Mardian Company under the payments bonds for the sums due from Pioneer? A. Yes.

Mr. Carr: Mark this.

(Plaintiff Apache's Exhibit 6 marked for identification.)

Q. (By Mr. Carr): I hand you Plaintiff Apache's Exhibit 6 for identification and ask you what that is.

A. This is a claim made by or for Apache Powder Company to Ashton-Mardian Company, Ashton Building Company, Pioneer Construction Company on indebtedness on the job, Corps of Engineers, U. S. Army Contract for Air Force Station, TM-181, at Ajo, Arizona.

Mr. Carr: We offer it in evidence.

Mr. Johnson: No objection.

Mr. Catlin: No objection.

The Court: It may be received.

(Testimony of Robert L. Henderson.)

(Plaintiff Apache's Exhibit 6 marked in evidence.)

Mr. Carr: Will you mark these?

Mr. Catlin: It is stipulated it was received and sent by registered mail, I believe, in the pre-trial conference.

Mr. Carr: It is offered for the purpose, your Honor, of showing exactly what the claim was. There has been an [168] allegation and admission a claim was made, but this for the purpose of showing just what it was.

The Court: Is it stipulated that the exhibit, the original of Exhibit 6 was received by the prime by registered mail?

Mr. Catlin: Yes.

The Court: On or about April 26th, 1957?

Mr. Catlin: It is so stipulated.

Mr. Carr: I was preparing the registered receipt for introduction.

(Plaintiff Apache's Exhibits 7-A, 7-B and 7-C marked for identification.)

Mr. Carr: We offer the registry receipts in evidence.

Mr. Johnson: No objection.

Mr. Catlin: No objection.

(Plaintiff Apache's Exhibits 7-A, 7-B and 7-C marked in evidence.)

Q. (By Mr. Carr): Mr. Henderson, I hand you Plaintiff Apache's No. 1 in evidence, a letter from Mardian Construction Company to Harold

(Testimony of Robert L. Henderson.)

Ashton, dated October 19, 1957 and——

A. March 19?

Q. March 19, 1957, thank you. And ask you if you note the amount stated in the first paragraph as due from Pioneer to Apache?

A. Yes, I note it. [169]

Q. Yes. Now, this sum is in round numbers \$25,000? A. Yes.

Q. Was that the approximate amount of the account at the date of this letter?

A. Yes, that was the approximate amount.

Q. Now, in our amended complaint we are asking for the sum of \$18,947.96. Between the time of this letter and the filing of the complaint, were there any payments or credits on this account?

A. Yes, there was one or more payments.

Q. Did Construction Materials make a payment after this date? A. Yes.

Q. And was there some credit to the account?

A. Yes.

Q. And that was by way of credit memo?

A. Well, there was an actual payment.

Q. Yes. A. An actual payment.

Q. The account was credited with a payment?

A. And also a credit memorandum later, yes.

Mr. Carr: Mark this.

(Plaintiff Apache's Exhibits No. 8 and 9 marked for identification.)

Q. (By Mr. Carr): I hand you Plaintiff Apache's Exhibit [170] No. 8 and ask you what it is, Mr. Henderson?

(Testimony of Robert L. Henderson.)

A. This is a credit memorandum issued by Apache Powder Company on August 28th, 1957 to Pioneer Constructors in the amount of \$175 for a blasting machine.

Q. And I hand you Plaintiff's Exhibit 9 for identification and ask you what that is?

A. This is a credit memorandum issued by Apache Powder Company August 14, 1957 to Pioneer Constructors for a total of \$1,777.73 for explosives and blasting supplies.

Mr. Carr: We offer them in evidence.

Mr. Johnson: No objection.

Mr. Catlin: No objection.

The Court: They may be received.

(Plaintiff Apache's Exhibits No. 8 and 9 marked in evidence.)

Q. (By Mr. Carr): Referring to Plaintiff Apache's Exhibit 8 in evidence, the credit memorandum of July 30, 1957 to Pioneer Constructors for \$175, what was the occasion of making that or giving that credit to Pioneer?

A. It was a credit for a blasting machine which had been charged to Pioneer Constructors on this Bisbee Highway job and later returned to Apache Powder Company. It was used there and returned and it had been charged to Pioneer, so we gave them credit when they returned it.

Q. Had it been used on the Ajo job? [171]

A. Yes, I believe it was used on the Ajo job later.

Q. When was it returned?

(Testimony of Robert L. Henderson.)

A. It was returned about the end of July or first of August, 1957.

Q. Referring to Plaintiff Apache's Exhibit No. 9, what was the occasion for giving that credit memo to Pioneer Constructors?

A. After we had delivered our last explosives to Pioneer Constructors at the Ajo job, which was March 12, 1957, we of course were anxious to get the magazines released by Pioneer Constructors on that job, so we could take them and supply them to contractors on other jobs. Of course obviously there was some powder used after we delivered it and eventually we got those magazines at the Ajo job, but we found that there were explosives and blasting materials and some accessories in the magazines. So we had an accurate inventory taken of the material in the magazines and issued this credit for that material.

Q. Was this credit memo mailed to Pioneer Constructors? A. Yes.

Q. Was it returned by Pioneer Constructors?

A. It came back to us.

Mr. Carr: Will you mark this.

(Plaintiff Apache's Exhibit 10 marked for identification.) [172]

Q. (By Mr. Carr): I hand you Plaintiff Apache's Exhibit No. 10 for identification and ask you what it is.

A. This is an envelope addressed to Pioneer Constructors, P. O. Box 2768, Tucson, Arizona. It is postmarked August 22nd, 1957. In addition to

(Testimony of Robert L. Henderson.)

the address it is stamped "Return to writer", also stamped, "Out of Business" and also written, "Out of Business," and has an initial on there.

Q. Is this the envelope in which the credit memo was returned from Pioneer Constructors?

A. Yes.

Mr. Carr: We offer it in evidence.

Mr. Johnson: No objection.

Mr. Catlin: No objection.

The Court: It may be received.

(Plaintiff Apache's Exhibit 10 marked in evidence.)

Q. (By Mr. Carr): Thereafter was the credit memo sent to Construction Materials?

A. Yes. This same credit memo or memos were sent by mail to Construction Materials, addressed to Construction Materials.

Q. Was it returned by Construction Materials?

A. No.

Q. Was there ever any objection from Construction Materials because the credit memo was issued to Pioneer Constructors? A. No. [173]

Q. I believe you have already said Apache Powder Company received some payments from Construction Materials? A. Yes.

(Plaintiff Apache's Exhibits 11-A, 11-B and 11-C marked for identification.)

Q. (By Mr. Carr): Mr. Henderson, I hand you Plaintiff Apache's Exhibit 11-A for identification and ask you what it is.

A. This is a remittance slip which had been

(Testimony of Robert L. Henderson.)

attached to a check received from Construction Materials Company, Construction Division, dated 12/27/56 in the amount of \$4,723.37.

Q. And Plaintiff Apache Exhibit 11-B?

A. This is a remittance slip which had been attached to a check received from Construction Materials Company, dated 2/12/57, in the amount of \$3,417.74.

Q. And Plaintiff Apache's Exhibit 11-C?

A. This is a remittance slip which had been attached to a check received from Construction Materials Company, dated 4/10/57, in the amount of \$4,411.91. In addition to that there are five invoices attached, invoices of Apache Powder Company to Pioneer Constructors.

Mr. Carr: We offer them in evidence.

Mr. Johnson: No objection.

Mr. Catlin: No objection. [174]

The Court: They may be received.

(Plaintiff Apache's Exhibits 11-A, 11-B and 11-C marked in evidence.)

Q. (By Mr. Carr): These remittance slips are the originals, are they? A. Yes.

Q. And did you deposit the checks represented by these remittance slips? A. Yes.

Q. And what was done in connection with those payments?

A. The payments were applied against the balance in the Pioneer account.

Q. Now, I note in connection with Plaintiff

(Testimony of Robert L. Henderson.)

Apache's 11-A and B there are no Apache Powder Company invoices attached?

A. That is right.

Q. Were they sent along with the checks and remittance slip? A. No.

Q. On Plaintiff Apache's Exhibit 11-A there is a reference to a statement: "Billed to Pioneer Const.", abbreviated, "Inv." and three numbers?

A. Yes.

Q. On Plaintiff Apache's Exhibit 11-B there is a statement: "Covers the following invoices," three numbers; [175] "Billed to Pioneer."?

A. Yes.

Q. I note on this "Pioneer" underscored in red and the word "Constructors" was added. Was that done in your office?

A. Yes, that was done by Apache.

Q. And the remittance slip gives the numbers of six invoices and the amounts? A. Yes.

Q. And were these invoice numbers checked to ascertain what they were? A. Yes.

Q. State whether or not they were invoices of Apache Powder Company to Pioneer?

A. They were.

Q. The first check covered what period?

A. Well, the first check covered invoices in, well, in November.

Q. Yes. The second check covered what period?

A. I would say approximately December and January.

Q. And the third check?

(Testimony of Robert L. Henderson.)

A. And the third check through March 12th.

Q. All the remaining invoices?

A. The remaining invoices.

Q. Issued after November 1, 1956? [176]

A. Yes.

Q. Did anything occur on or about December 4, 1956 with respect to the Ajo job and the invoices to Pioneer?

A. Yes.

Q. What happened?

A. Well, on December 4, 1956, or on or about December 4, 1956, there was reported to me receipt of a telephone call on December 4th, 1956 from the Pioneer Constructors job at Ajo, in regard to——

Q. According to the report to you as general manager, who did this statement come from?

A. The report came to me—there was a telephone call from Mr. Swagerty of Pioneer Constructors at Ajo.

Q. To whom?

A. The call came to our shipping clerk at the same time that an order for explosives was telephoned to the shipping clerk.

Q. What was his name?

A. Paul Negley.

Q. What was the substance of that conversation as reported to you as general manager?

A. The substance of the conversation that was reported to me was a request by Mr. Swagerty of Pioneer Constructors that the balance of the invoices for explosives for the Ajo job should be

(Testimony of Robert L. Henderson.)

sent to Construction Materials Company, [177] Construction Division, a division of Pioneer Constructors.

Q. At the time of that report, you said it was given in connection with an order for materials, had any shipments been made to Ajo subsequent to November 1, 1956 and prior to this request by Mr. Swagerty?

A. Yes, it is my recollection that they were.

Q. Kindly refer to Plaintiff Apache's Exhibit No. 4 and if you find any such shipments, state what they were.

A. There is a shipment on November 2nd, 200 cases of explosives; a shipment on November—well, I don't know whether I said November 2nd, 1956—again on November 14, 1956, a shipment of 200 cases of explosives; a shipment on November 28th, 1956 of blasting caps, and a shipment on December 4th, 1956.

Q. That was the order phoned in at the time Mr. Swagerty made this request? A. Yes.

Q. Did this request refer to invoices subsequent to November 1, 1956, or just to invoices subsequent to the telephone conversation?

A. According to my understanding it was subsequent to the telephone conversation.

Q. Now, did you thereafter invoice to Construction Materials? A. No. [178]

Q. Why did you not do so?

A. Well, there are a number of factors that we considered in our action, taking action. Our

(Testimony of Robert L. Henderson.)

arrangement for supplying explosives and for the loaning of magazines had been made with Pioneer Constructors for this job, the subcontractors on the job. We had had no notice that the subcontract with Pioneer Constructors had ever been terminated at that date, we had no such notice. We had not been approached by Construction Materials and we had made no arrangements with them for sale or delivery of explosives or for loan of magazines. We had had no protest about our billing to Pioneer Constructors and we went ahead and did all of our billing and dealing with Pioneer Constructors and we had no protest in going ahead that way.

Q. Now, those invoices you referred to a moment ago of shipments in November, 1956, were they returned for correction? A. No.

Q. The bills of lading for such shipments, were they receipted in the name of Pioneer Constructors?

Mr. Johnson: Objection, your Honor. The records speak for themselves.

The Court: The records are the best evidence.

Q. (By Mr. Carr): Was there any objection made by Pioneer Constructors or Construction Materials to the continued addressing of shipments to Pioneer Constructors? [179] A. No.

Q. Mr. Henderson, did you discuss this request of Swagerty's for invoicing to Construction Materials with other people in your organization?

A. Yes.

(Testimony of Robert L. Henderson.)

Q. And the reasons you have just given were the reasons after this considered action, I mean this consideration of the question?

A. Yes. It was after discussion and consideration among our people.

Q. And at that time did you and the heads of the department, the people you discussed this matter with, at that time believe that Apache Powder Company was delivering this material to Pioneer Constructors under the Pioneer Constructors contract of March 30, 1956? A. Yes.

Q. Now, thereafter, when you received these checks from Construction Materials in payment of Apache Powder Company invoices to Pioneer Constructors, was this fact also considered by you and the people in your organization?

A. Yes.

Q. And what was the result of that consideration? A. That is in regard to the——

Q. The receipt of moneys from Construction Materials or Pioneer invoices? [180]

A. Well, we considered it and discussed it and decided it was all right for us to accept these checks from Construction Materials to apply on the Pioneer Constructors account.

Q. For what reason?

A. Well, because the only statement we had had was this telephone call and it said, "Construction Materials Company, a division of Pioneer Constructors"; and the only account we had on

(Testimony of Robert L. Henderson.)

this Ajo job was the Pioneer Constructors account, so we applied it to that account.

Q. During the progress of this work at Ajo, Mr. Henderson, did your field engineers continue periodically to visit the work at Ajo?

A. Yes.

Q. And report back to you? A. Yes.

Q. Did they report any unusual circumstances in connection with the work progressing at Ajo?

A. No.

Q. Any interruption in the work schedule?

A. No.

Q. Any change of management or personnel?

A. No.

Q. Any change in equipment? A. No.

Q. And you as the supplier for Pioneer were continuing [181] to supply the powder and blasting supplies to the job? A. Yes.

Q. Referring to Plaintiff Apache's Exhibit 4, the file of invoices and bills of lading, each of the invoices contain a description of kind and quantity of material and price, does it not? A. Yes.

Q. What was that price that you used?

A. Well, it was a price, a net price which was made up from current list prices of those materials, less discount customarily given to contractors for this sort of work.

Q. And Pioneer had a copy of those list prices?

A. Yes.

Q. And was there any question in regard to the prices on any of this material? A. No.

(Testimony of Robert L. Henderson.)

Q. You are in this business, Mr. Henderson; were those reasonable prices for those supplies listed in these invoices and delivered to the job?

A. Yes.

Mr. Johnson: Your Honor, I object to this line of questioning. There is no issue in the case as to reasonableness of the charges; they haven't been raised or questioned.

Mr. Carr: I don't know that it has been admitted.

The Court: I take it there is no issue. [182]

Mr. Johnson: There is no issue on that.

Mr. Carr: All right.

(Recess.)

(After Recess.)

Q. (By Mr. Carr): Mr. Henderson, shortly after August 15, 1957, were you informed by your attorneys of the taking of the depositions of Mr. Skorpick and Mr. Simmons in Tucson?

A. Yes, sir.

Q. Were you informed that Mr. Melvin J. Simmons in his testimony, the taking of that deposition, reported a call to the bookkeeping or accounting department of Apache Powder Company on or about December 10, 1956? A. Yes.

Q. Did you make an investigation to determine whether or not such a call was made?

A. Yes.

Q. Was such a call made to Apache Powder?

A. No.

Mr. Johnson: I object to that, strictly a hear-

(Testimony of Robert L. Henderson.)

say statement of the hearsay of this witness. He can testify no call was made to him, but he wouldn't know whether any call was made to anybody else. It is certainly hearsay.

Mr. Carr: Your Honor, Mr. Henderson is on the stand here as manager and acting head of the corporation and in [183] charge of all the operations. I believe in that capacity he has a full authority to say that he received certain information, that he made an investigation and as a result of the investigation he found no call was made.

The Court: No, I don't believe that is right, Mr. Carr. These are long distance calls, aren't they?

Mr. Carr: Yes.

Q. (By Mr. Carr): Did you ever hear of such a call?

Mr. Johnson: We object to that as immaterial.

Mr. Carr: I am asking him personally.

A. No.

The Court: He may answer that.

A. No.

Q. (By Mr. Carr): If such a call had been made to Apache Powder Company who would have received it?

Mr. Johnson: If the Court please, we object to that as calling for a conclusion of this witness. Undoubtedly Apache Powder Company has quite a few employees down there; I don't think this witness can say who received a certain call.

The Court: The testimony was that he made

(Testimony of Robert L. Henderson.)

the call and had been put in touch with the accounting department. He may answer that question.

A. If a call came to the accounting department of our company, it would be referred either to the secretary-treasurer, Mr. Schmalzer, or in his absence the assistant secretary-treasurer, Mr. Browning. As calls come through our switchboard they would be directed to the proper place.

Mr. Carr: That is all.

Cross Examination

Q. (By Mr. Catlin): Mr. Henderson, what were the credit terms which you extended to Pioneer Constructors on the sale of the powder?

A. Our usual open account terms for this sort of business.

Q. Which are what?

A. Net cash thirty days.

Q. Thirty days net cash? A. Yes.

Q. You have made mention, Mr. Henderson, of the subcontract to Pioneer from Ashton-Mardian. Did you ever see such a document prior to the time—prior to March 19th?

A. Did I ever see—

Q. The subcontract with Pioneer by Ashton-Mardian? A. No.

Q. And then the only reason you knew that they were a subcontractor on the job was that you were told by someone from Pioneer, is that correct?

(Testimony of Robert L. Henderson.)

A. I would hardly say that is correct. I would say that [185] information came to me in my capacity from several sources.

Q. But at that time, I will ask you, did you have any knowledge as to the contents of such a subcontract, if the same existed?

A. Not any detail.

Q. I believe you have stated that this was a pure open account sale to Pioneer Constructors?

A. Yes.

Q. There was no written agreement between you and Pioneer Constructors as to the furnishing of the blasting materials?

A. No written agreement, but they were supplied as a customary copy of our——

Q. Price list?

A. ——price list, and that shows the terms.

Q. There was no difference in this price list and any price list you would supply any other contractor on a job of this nature, was there?

A. No, not for any given material.

Q. Do you know who contacted Apache Powder from Pioneer at the start of the furnishing of the blasting material on the Ajo job?

A. There were contacts made with more than one of the Pioneer people, that is, by Apache representatives.

Q. You don't know of any specific individual?

A. I know of some, yes, I know of some individuals. As I say, I did not make the contract, but they were made by our field people.

(Testimony of Robert L. Henderson.)

Mr. Catlin: Would you mark this for identification?

(Defendant Ashton's Exhibit A marked for identification.)

Q. (By Mr. Catlin): Let me hand you Defendant Ashton's Exhibit A for identification and ask you if you know what that is?

A. Yes, that is a statement of Pioneer Construction accounts receivable, the amount owed Apache Powder Company, posted to November 24, 1936, furnished by Apache Powder Company, C. M. Quinn, who at that time was secretary-treasurer.

Q. I believe this was actually furnished to me at my request?

A. Yes, it was furnished at your request. As it points out, it is a confirmation.

Q. After you had talked to me on the telephone about it? A. Yes.

Q. Is this then an accurate statement up to March 22d of the condition of the account, Apache's account on the Ajo job—I won't say with Pioneer Construction Materials.

A. Yes, to my best knowledge that is an accurate account.

Q. It is correct that this account shows that it laid up to the date of the letter, which is received by the Ashton [187] Company on April 12, 1937, that Apache had not received any payments whatsoever for powder and blasting materials furnished prior to November 1, 1936?

A. That is correct.

(Testimony of Robert L. Henderson.)

Q. And they have not as of this date received any payments for blasting materials furnished prior to that date, other than the credit which was issued, which may be reflected in these prior invoices? What I am saying—I am not trying to trap you.

A. No, but let me explain if I may. That from our standpoint the money that we received from Construction Materials on Construction Materials' checks for Pioneer Constructors' powder invoices, from our standpoint we applied that against the balance, the entire balance of Pioneer Constructors.

Q. I don't want to be argumentative; that is not in accordance with this account then because you will note, Mr. Henderson, that the amount paid and shown as paid by Construction Materials here have been shown as being paying individual invoices, isn't that correct?

A. There are some invoices checked off on those.

Q. As being paid by invoices, as being paid by Construction Materials?

A. There are some checked. Of course, I don't know who checked them.

Mr. Catlin: I don't believe I offered this in evidence, [188] your Honor.

Mr. Carr: May we see it, please?

The Witness: What I mean to say, it acts to reduce the whole balance.

Mr. Carr: No objection.

The Court: It may be received.

(Defendant Ashton's Exhibit A marked in evidence.)

(Testimony of Robert L. Henderson.)

(Defendant Ashton's Exhibit B marked for identification.)

Q. (By Mr. Catlin): Mr. Henderson, I show you Defendant Ashton's Exhibit B for identification and ask you if you know what that is?

A. Yes. This is a letter, dated April 12, 1957, directed to the Ashton-Mardian Company, informing Ashton-Mardian Company of the condition of the account of the subcontractor on the Ajo job.

Q. That was also sent at my request, was it not? I believe it so states in here, outside of the fact I won't get on you for misspelling my name.

A. I am sorry about that.

Mr. Catlin: I offer this in evidence.

Mr. Carr: No objection.

The Court: It may be received.

(Defendant Ashton's Exhibit B marked in evidence.)

Q. (By Mr. Catlin): I will ask you with regard to this [189] letter, Mr. Henderson, and with your permission I will read one paragraph of it to you.

"Beginning with June 24, 1956, Mr. Paul A. Swagerty ordered all of the material. These orders included twenty-two out of the thirty made. On December 4, 1956, we received a telephone message from Mr. Swagerty requesting a shipment of twenty-eight cases of powder and asking that it be charged to Construction Materials Company. Mr. Swagerty indicated that Construction Materials Company is a division of Pioneer Constructors, Inc. This was the first information we had that

(Testimony of Robert L. Henderson.)

there was any connection between the two companies. Mr. Swagerty said nothing about an assignment of the subcontract to Construction Materials Company and the first we learned about any change in the status of the contract was from Mr. Daniel Mardian of Mardian Construction Company about March 19, 1957. As yet, we have had no formal notice of any change in the terms in the status of the subcontract and still do not know the terms and conditions on which the change was made."

Is that an accurate statement as you recall now of the facts, was there any change you would like to be made in that statement? Do you want to read it for yourself?

A. There is no essential change which occurs to me. This statement: "Mr. Swagerty said nothing about an assignment of the subcontract to the Construction Materials Company [190] and the first we learned about any change in the status of the contract was from Mr. Daniel Mardian of Mardian Construction Company—". I said it came to me personally through our attorneys, but——

Q. You are speaking——

A. I am speaking, yes, but it doesn't occur to me there is anything substantial.

Q. The information which you wrote me at that time, Mr. Henderson, and on which this is based, came largely from the records of Apache Powder Company, the notes, memorandums and things of that nature, is that correct?

A. Yes.

Q. Were you familiar with all of the circum-

(Testimony of Robert L. Henderson.)

stances, and directing your attention to especially December 4, 1956?

A. Yes, I feel that I was aware of the circumstances.

Q. Is it a practice of the officers and employees of Apache Powder Company to make written memoranda of their telephone calls and dealings with customers?

A. It is a general practice.

Q. I am showing you a portion of Plaintiff Apache's Exhibit No. 3, and especially in connection with—and I believe you call these factory——

A. Factory orders.

Q. Factory orders, which is dated December 4, 1956, and being factory order No. 22046, and showing you a pencil [191] memorandum attached to this factory order and ask you what that is?

A. This is a pencil notation recording an order and it is made by, obviously by our shipping clerk, Paul Negley. The initials are "P. N." That was information about the order.

Q. Is that Mr. Negley's handwriting?

A. Yes, I am satisfied that it is.

Q. And this, you say, is a pencil notation of an order received by Apache? A. Yes.

Q. And according to that pencil notation who made the order?

A. That is who gave us the order, you mean?

Q. Yes. A. Swagerty.

Q. And I gather then, the order says: "Con-

(Testimony of Robert L. Henderson.)

struction Materials Company, Construction Division”?

A. Yes. Ordinarily, I think almost invariably the person who takes an order or information over the telephone will attempt to record it just as it is given. And that is what has been done.

Q. Would you read Mr. Negley’s notes here?

A. Yes. “Balance job at Ajo to Materials Construction Division, Phone Swagerty P.M. 12.04. Above is division of [192] Pioneer Constructors.”

Q. Do you have any reason to know whether they were put on at separate times or at the same time?

A. At the same time.

Q. Do you know? A. Yes.

Q. You saw him write it?

A. I didn’t see him write it, but it was reported. He has put his initials on it. It was reported at the same time.

Q. Do your initials appear on here, Mr. Henderson? A. Yes.

Q. And under what statement do they appear?

A. “Please continue billing Pioneer Constructors. R.L.H. 12/4/56.”

Q. I ask you, Mr. Henderson, how long did you consider—I believe you have stated that you had a discussion and considered how you were going to handle the balance of this job over here in view of the request that it be billed to Construction Materials. Who all specifically did you discuss this matter with?

(Testimony of Robert L. Henderson.)

A. With, I am sure with the people in our accounting department.

Q. Did you discuss it with Mr. Neely?

A. Mr. Neely? [193]

Q. I am sorry, the man's name——

A. Mr. Negley.

Q. Negley.

A. Yes, sir. He is in the accounting department and they were largely accounting personnel I believe with whom I discussed.

Q. Did you call or write or in any way make inquiry of Ashton-Mardian Company as to what possible reason there would be for that request?

A. No.

Q. Did you make any request to any of the officers of either Construction Materials Company or Pioneer Constructors as to the reason for the request for the changed billing, future billing?

A. No.

Q. Had you ever heard of Construction Materials Company prior to December 4, 1956?

A. I had some knowledge of Construction Materials Company prior to December 4th.

Q. And what was the nature of your acquaintanceship with them or of them?

A. Well, we had not done business with them. My only recollection of hearing of Construction Materials Company prior to this December 4th was in, one at least, Dun & Bradstreet report, in which Construction Materials Company [194] was named as a related company to Pioneer Constructors.

(Testimony of Robert L. Henderson.)

Q. And you had then seen the Dun & Bradstreet rating on Construction Materials Company?

A. No, not on Construction Materials Company, on Pioneer Constructors.

Q. You just stated that Construction Materials Company was listed as a related company?

A. Yes, but not a report on them. They were named as a related company to Pioneer Constructors in a report on Pioneer Constructors.

Q. You were familiar with that fact on December 4th or prior thereto?

A. In that way.

Q. And that is your reason for the statement in the letter that this is the first information you had there was any connection between the two companies?

A. Well, the only information that we had from the Company.

Q. Is it the policy of Apache Powder Company to rely on a construction job in which you are dealing with a subcontractor, to rely almost exclusively upon the bond of the prime contractor for payment?

A. We place very strong reliance in that, on the bond of the prime contractor for payment.

Q. Is it also the policy of Apache Powder Company when [195] an order is given to it and a request made it be billed to a certain corporation, to not do so, but continue to bill otherwise?

A. If Apache Powder Company were notified in some official manner I am sure that the Apache Powder Company would comply with the request.

(Testimony of Robert L. Henderson.)

Q. You did not feel that the request of the man who had made all of the purchases prior to that time was an official request?

A. I don't believe we would have considered it that way; on such an important thing as a change in a contract or subcontract, that we would get, you might say, a rather casual statement on the telephone from the man that orders the powder to make such a change.

Q. You have already said, Mr. Henderson, you had never seen the subcontract?

A. I wouldn't say I would have had to have seen it to be satisfied that there was a subcontract.

Q. I believe it is stated in your letter and I believe you stated as a fact—I may be wrong here—that almost all of your dealings with this particular job over there were by phone order, is that correct?

A. That is correct.

Q. Is it the policy of Apache Powder Company where its credit terms are cash thirty days, when they are dealing with [196] a subcontractor on a job like this, to go for a period of over six months without any payment before making any inquiry of the prime contractor of the condition of a sub on the job?

A. Will you repeat the question, that is the first part of the question?

(The last question was read.)

A. I would say it is not the policy of the Apache Powder Company to do that, although it is not unusual for that sort of thing to happen in this type

(Testimony of Robert L. Henderson.)

of work, that is, with the contractors. There are certain things that we do. We don't like to go to the prime contractor and embarrass the subcontractor if we can avoid it. We have men in the field who watch the jobs and note whether there is anything unusual going on and report. In this case we had nothing unusual reported. We feel that the intent of a payment bond of a prime contractor is to protect the suppliers and we rely upon that, we have and we do in all cases of contract work.

Q. Do you realize, Mr. Henderson, that in relying on the bond of the prime contractor and by letting things like this go on that you are in effect, if the prime contractor is worth anything in a financial way, putting the burden on the prime contractor? The bonding companies don't have the practice of just paying it out and not getting it back from their principal, you are aware of that situation?

A. Yes. [197]

Q. Mr. Henderson, have there been many occasions in which you have received payment on account with checks and vouchers, indicating specifically what invoices are to be credited with that payment?

A. You say have we received——

Q. Do you receive many payments, checks and vouchers of that nature?

A. Yes, we receive checks of that nature.

Q. What is the usual reason for payment of individual invoices where there are prior amounts owing?

(Testimony of Robert L. Henderson.)

A. Well, I think it would be our experience it is a way of doing business. We have people that specify certain invoices and those that just pay on account. It is just a matter of how they want to do business.

Q. It doesn't raise any question in your mind as being anything out of the ordinary when you receive checks and vouchers of that nature?

A. That is specifying certain invoices?

Q. Yes. A. No, it isn't unusual.

Q. Does it raise any question in the mind of Apache Powder Company and yourself in particular when you have an account that is six months old without any payment and then out of a clear blue sky you start getting checks from another organization, so far as the checks themselves show, in payment of the [198] last invoices?

A. Yes, we note that. That is the reason, as I say, we gave consideration to our course and we reviewed our information from the field in regard to the job and we have got this — our experience with the subcontractor, Pioneer, had been very good before and at that point we could well believe we were going to be paid. And in addition to that we have confidence in the prime contractor.

Q. In other words, you at that point started putting your reliance on Pioneer, is that correct? You have already stated you did not acquaint the prime contractor with the situation, either as to the method in which you were receiving payments, or the fact that you had received a telephone request

(Testimony of Robert L. Henderson.)

to bill to Construction Materials, you have already stated you did not in any way contact the prime contractor regarding the situation at that time. Does that mean you were putting your reliance on Pioneer?

A. No, not altogether. We were putting our reliance in all these places where the account should be taken care of. We weren't concentrating particularly on Pioneer. There is a competitive angle here too, Mr. Catlin. In this business of dealing with the contractors we have many contractors who pay regularly; unhappily we have a few who don't, and it is customary in our industry to go along with these contractors. And if we were to be too rigid and inflexible we would lose [199] a lot of the business because our competitors will be liberal and in many cases more liberal than we.

Q. In other words, Apache is no different than a lot of other contractors or a lot of suppliers, it is the volume in the competitive end and relying, placing your reliance on the prime to back you up in any credit mistakes you might make?

A. No, I wouldn't say that is a correct statement of what I said.

Q. There is one other thing then I am through, Mr. Henderson. I note that there are two order slips, apparently by Mr. Negley, on date of December 4th. Is there any way of telling whether that was one phone call or whether it was two separate calls?

A. I do not know frankly. I don't believe I can

(Testimony of Robert L. Henderson.)

say, except the way it was reported to me was that it was one call.

Q. Both of these were made, I notice the first one was made out to Construction Materials Company and that is where the language is you described before; I notice the other one is made out Construction Materials Company and with ditto marks, Construction Division, and that has been crossed out and "Pioneer Constructors" written in?

A. Yes.

Q. You think that would probably be one call, you are not positive?

A. As far as I can say, it was just one call. [200]

Mr. Catlin: No further cross examination from this defendant.

Cross Examination

Q. (By Mr. Johnson): As I understand your testimony, you said, I believe, on December 4th you received information from somebody in your accounting department that Mr. Swagerty by telephone request had requested, in connection with an order, that from then on you make your bills to Construction Materials? A. Yes.

Q. After considering it with other people in your organization you decided, for reasons that seemed sufficient to you, that you weren't going to do it that way, you were going to keep on billing Pioneer? A. Yes.

Q. The thing that mystifies me in that testimony, Mr. Henderson, is this, that when a customer which is apparently as large a volume customer as

(Testimony of Robert L. Henderson.)

these people were, make a request to you, that you decide not to comply with it, you go ahead and not comply with it without telling them your reasons or anything else. Isn't that rather unusual? I can understand your not complying with the customer's request, but don't you generally have a little discussion with him about it when you are not going to comply? [201]

A. I think the way that the request came was rather unusual, and I guess it is repetition, but I believe if the request had come to us in what we considered the proper way that we would have discussed it and complied if it was all in order.

Q. You didn't even feel like you should call Mr. Simmons, Mr. Skorpick or anybody else and find out what this was all about and find out why they wanted that change made and discuss your reasons for not wanting to make it?

A. No, we didn't feel that was indicated at the time.

Q. However, on December 4th you did know through the basis of this telephone call, or had it called to your attention that some entity out there known as Construction Materials, which you thought you had reason to believe was a division of Pioneer, but anyway that somebody called Construction Materials was now on the job, because that request had been made? A. Yes.

Q. When you received your first payment, which I believe was about December 19th, somewhere along there, was it?

(Testimony of Robert L. Henderson.)

A. Yes, December 19th or 17th. I don't recall the exact date.

Q. When you received that payment you knew of course this same entity, Construction Materials Company, was the one that was signing the check?

A. Yes.

Q. It was their account that was paying you. You also knew from the examination of the voucher or remittance slip attached to that check that the invoices the Construction Materials were paying were the current latest invoices and they were not paying on this old Pioneer account, you knew that?

A. I saw the remittance statement.

Q. As a business man didn't all these things add up that there had been some change of some kind, something was going on and an investigation might be in order?

A. We made an investigation.

Q. What investigation did you make at that time?

A. In the field we—that is in the field and in the continuation of orders coming into us it continued to be exactly the same personnel, reported the same management, the same job, the same equipment; no protest in going on and doing business in the way we had been doing it with Pioneer Constructors, with whom we had arranged to do the business.

Q. Didn't you consider Mr. Swagerty's phone call requesting you do it the other way was in effect a request?

A. The way he put it wasn't as disturbing as if

(Testimony of Robert L. Henderson.)

it had been a direct notification to us that this subcontract with Pioneer Constructors has been terminated and one has been let to Construction Materials. All he said was—that is, [203] it is reported—Construction Materials Company, a division of Pioneer Constructors. So it would be natural to assume from that we were still doing business with Pioneer Constructors. If they choose to call it one division or another, that is within their organization I presume.

Q. Knowing these facts, Construction Materials was there, you were being paid by their checks, that they requested you to bill it to them, and that their checks were only paying their current invoices, why didn't you go to Mr. Ashton, Mr. Skorpick, Mr. Simmons or someone else in a responsible position in these organizations that could have given you the straight facts?

A. We felt that it was the duty of the contractor, subcontractor or prime contractor to give us adequate notification.

Q. In other words, you considered all these factors and came to that conclusion, they should give you notification, that you should sit back and not do anything until they gave you formal notification, is that right?

A. That we should continue with the account as we had it set up until we got some formal notification.

Mr. Johnson: May I see Exhibit 5?

Q. (By Mr. Johnson): You have included in

(Testimony of Robert L. Henderson.)

Exhibit 5, which is your statement over a period of months, are addressed to Pioneer Constructors?

A. Yes.

Q. The way they are set up they show the old balance and list the current invoices for the preceding month?

A. Yes.

Q. Credits or payments that might have been made over the preceding month, is that right?

A. Yes.

Q. All the time December, 1956, January, 1957, February, '57, March, '57, all the way through you kept sending them out the same way?

A. Pioneer Constructors?

Q. Yes. A. Yes.

Q. After March you certainly knew of course that Pioneer wasn't on the job, you had been officially notified by that time?

A. Yes.

Q. Certainly in April and May you knew it?

A. Yes.

Q. I notice here on March 31st, 1957, after you had been notified, you sent out a bill to Pioneer Constructors showing in March invoice to them still the same way, didn't you?

A. Yes. The balance was against Pioneer Constructors of course.

Q. Did you ever make any inquiry of anyone up until you [205] got what you call official notification of this changed situation to find out why Pioneer Constructors were paying you by their check and specifying the current invoices and not paying off

(Testimony of Robert L. Henderson.)

the balance of the account, if as you thought it was all Pioneer Constructors account?

Mr. Carr: I object to the question. It has been asked and answered, I believe, more than once.

The Court: He may answer.

Mr. Johnson: Will you repeat the question?

(The last question was read.)

A. No.

Mr. Johnson: That is all.

Cross Examination

Q. (By Mr. Fickett): Mr. Henderson, during all this time you knew Mel Simmons personally, didn't you?

A. No, I did not know Mel Simmons personally and don't yet.

Q. You didn't know he was in charge of the office of Pioneer?

A. I knew that at one stage, but that was after, I think along in March of 1957, as I recall, I got that information.

Q. When you got this information from Mr. Swagerty on [206] the 12th of December, you never took the trouble to call the Pioneer office or Construction Materials office in Tucson and make inquiry there, did you, about the situation?

A. No.

Mr. Fickett: That is all.

(Witness excused.)

PAUL NEGLEY

called as a witness herein, having been first duly sworn, testified as follows:

Direct Examination

Q. (By Mr. Carr): Your name is Paul Negley?

A. Yes, sir.

Q. Where do you reside, Mr. Negley?

A. 5719 East Baker Street, Tucson, Arizona.

Q. Are you employed by Apache Powder Company?
A. Yes.

Q. Were you employed by Apache Powder Company in the period between June 13, 1956 and March 12, 1957?
A. Yes.

Q. What was your position with the Company?

A. The shipping clerk and billing clerk.

Q. What department of the company is that in?

A. It was in the accounting department.

Q. Who was your immediate superior?

A. Mr. J. L. Schmalzer.

Q. What was his position with the Company?

A. He was at that time, 1956, he was assistant secretary and assistant treasurer.

Q. Did you have anything to do with the orders in connection with the furnishing of materials to the Ajo job?
A. Yes, sir.

Q. What, briefly, did you do in that connection?

A. I received the orders by telephone and arranged to make the deliveries in accordance with the availability of the materials requested and availability of trucks to make the delivery.

(Testimony of Paul Negley.)

Q. What documents, if any, were prepared under your immediate direction?

A. The factory order was prepared under my immediate direction and the bill of lading for shipment of the material and the invoice.

Q. Were copies of the factory order and invoices regularly sent to customers at the time they were made?

A. Yes. The copy of the factory order was representing acknowledgment of the orders, was mailed to the customer to whom it was sold, and at the time the powder was to be shipped I had caused the bill of lading to be made. [208]

Q. You just stated, Mr. Negley, that you handled the phone orders on this job. Were all the orders by phone rather than on a written order form?

A. All the orders were by telephone.

Q. From whom did you receive these orders?

A. Mr. Swagerty on the job at Ajo.

Q. Do you know his full name?

A. His full name is Paul A. Swagerty.

Q. In connection with the receipt of orders, when did he first start to phone in the Pioneer orders on this job?

A. The first order I received by telephone from Mr. Swagerty was June 22nd, 1956.

Q. Did he thereafter phone in all the orders that were made for the Ajo job?

A. To my knowledge those that I received for the Ajo job were all phoned in or taken by phone from Mr. Swagerty by me, for those.

(Testimony of Paul Negley.)

Q. Did you receive all the orders that he phoned in?

A. No, I wouldn't say I received all of them.

Q. Do you recall how many you received?

A. I received approximately nineteen.

Q. Did those include all of the orders received by Apache Company subsequent to November 1, 1956?

A. Yes, sir.

Q. I call your attention to one of the factory orders [209] Plaintiff Apache's Exhibit 3, that is the factory order of December 4, 1956. Did you prepare this factory order?

A. Yes, sir.

Q. What was the source of the information from which this order was prepared?

A. It was a telephone order from Mr. Swagerty.

Q. At the time of that telephone conversation did you make pencilled notes of the contents of the conversation, the statements made?

A. Yes, sir, I did.

Q. And I refer to the first pencilled sheet attached to this factory order of December 4, 1956, and ask whether or not you made out that pencilled notation?

A. Yes, sir, I did.

Q. With exception of the statement in ink at the bottom, initialled by Mr. Henderson?

A. That is right.

Q. What generally does that pencilled note contain?

A. It generally contains the material that the customer wishes to have delivered.

Q. At the top left hand side appears the words,

(Testimony of Paul Negley.)

“Construction Materials Company, Construction Division, Tucson, Arizona.” Do you recall the purpose of that notation?

A. Yes. Mr. Swagerty informed me upon giving me this order that the balance of the materials for the Ajo job should [210] be billed to Construction Materials Company, Construction Division, Tucson, Arizona, and that this division, this company is a division of Pioneer Constructors.

Q. Down below you have, there is a statement: “Above is division of Pioneer Constructors,” with the address. You made that as a notation from Mr. Swagerty’s statement? A. Yes, sir.

Q. The second pencilled sheet, it started, “Construction Materials. C (Blank) Div,” which is stricken and “Pioneer Constructors” is put in?

A. Yes.

Q. Do you recall making that second notation?

A. Yes, I do.

Q. What was the purpose of the second notation?

A. It was to divide the order, inasmuch as the original request for materials was 160 cases of blasting supplies and my stock, either my stock or the fact that I did not have a big truck to ship that much, made it inevitable I must ship a partial shipment of 28 cases, which is noted here, which is a part of the original.

Q. So that was made subsequent to the telephone conversation with Mr. Swagerty after you had learned the amount of material you had on hand?

(Testimony of Paul Negley.)

A. Yes, sir.

The Court: It is 12:00 o'clock. We will stand at [211] recess until 1:30.

(Whereupon a recess was taken at 12:00 o'clock noon, until 1:30 o'clock p.m.) [212]

March 5, 1958, Afternoon Session

PAUL NEGLEY

previously called and sworn, resumed the stand and testified further as follows:

Direct Examination—(Continued)

Q. (By Mr. Carr): Mr. Negley, you were testifying as to the conversation with Mr. Swagerty on December 4, 1956. Did you report this to your superiors? A. Yes, sir.

Q. To whom? A. To Mr. Schmalzer.

Q. Were you employed and on the job at all times during December, 1956? A. Yes, sir.

Q. Did you receive a telephone call from Mr. Simmons of Construction Materials?

A. No, sir.

Mr. Carr: That is all.

Cross Examination [213]

Q. (By Mr. Catlin): Mr. Negley, just one question. May I have the so-called factory orders. Calling your attention, Mr. Negley, to the notations which I believe you call this an order memo, something like that, you made when you received the telephone call from Mr. Swagerty?

A. Yes, sir.

(Testimony of Paul Negley.)

Mr. Carr: What date?

Mr. Catlin: December 4, 1956.

Q. (By Mr. Catlin): May I ask, during the time that you were talking to Mr. Swagerty on the phone, how much of this notation was made by you at that time while you were talking to Mr. Swagerty on the phone, if you recall?

A. Yes, I recall. I made the notation immediately when one of the balance of the requirements at Ajo to be billed to Construction Materials, Construction Division, and then he gave me the company name, Construction Materials Company, Construction Division, Tucson, Arizona, and I noted what he said as I put it here above is "Division of Pioneer Constructors."

Q. Did you make this notation here at the same time that you made—while you were talking to Mr. Swagerty on the phone?

A. Yes, sir.

Q. Is there any reason why you would date this the same time and then go to another place on there and also date it [214] again? I beg your pardon, it is not dated.

A. I was using the space to allow my notation inasmuch as the body of my notation I have the specification for the material required.

Q. This about the above is a division of Pioneer Constructors, you are positive Mr. Swagerty told you this and this wasn't an assumption on your part?

A. I am positive Mr. Swagerty told me that.

Mr. Catlin: No further questions.

(No further questions indicated.)

J. L. SCHMALZER

called as a witness herein, having been first duly sworn, testified as follows:

Direct Examination

Q. (By Mr. Carr): State your name.

A. J. L. Schmalzer.

Q. Where do you live, Mr. Schmalzer?

A. Benson, Arizona.

Q. Do you hold a position with Apache Powder Company? A. I do.

Q. During the period March 30, 1956 to March 12, 1957, did you hold a position with Apache Powder? A. I did.

Q. What was your position during that period?

A. Assistant secretary and assistant treasurer.

Q. What were your principal duties as such officer?

A. I was fully in charge of the accounting department.

Q. At that time was Mr. Negley, who just testified, a billing and shipping clerk in that department? A. He was.

Q. Who was your assistant in the accounting department? A. Amos Browning.

Q. Have you been in the courtroom during all the trial of this case? A. I have.

Q. You heard the testimony of Melvin J. Simmons in regard to a telephone conversation, call to Apache Powder Company on or about December 10, 1956? A. I did.

Q. Did you receive that call? A. I did not.

(Testimony of J. L. Schmalzer.)

Q. Would you in the ordinary course of the handling of business for Apache Powder receive that call if you had been present and on the job?

Mr. Johnson: I object to that as calling for his conclusion.

Q. (By Mr. Carr): Who would receive a call that came to Apache Powder Company with the request to talk to the bookkeeping or accounting department? [216]

Mr. Johnson: I object.

A. It would have been directed to me.

The Court: The answer may stand.

Q. (By Mr. Carr): If you happened to be absent from your office at the time, who then would it have been directed to? A. Mr. Browning.

Q. Your assistant? A. My assistant.

Q. In charge of the accounting department. Did you receive a call from Mr. Simmons on or about that date? A. I did not.

Mr. Carr: That is all.

Mr. Johnson: No questions.

Mr. Carr: You may step down.

(Witness excused.)

AMOS J. BROWNING

called as a witness herein, having been first duly sworn, testified as follows:

Direct Examination

Q. (By Mr. Carr): State your name?

A. Amos J. Browning.

(Testimony of Amos J. Browning.)

Q. Where do you reside, Mr. Browning? [217]

A. Benson, Arizona.

Q. Are you an employee of Apache Powder Company? A. I am.

Q. Were you an employee of Apache Powder Company during the period March 30, '56 to March 12, '57? A. Yes, sir.

Q. What was your position with the Company during that period?

A. I was assistant to Mr. Schmalzer in the bookkeeping department.

Q. If a call came to the bookkeeping department or the accounting department of Apache Powder and Mr. Schmalzer didn't happen to be present, to whom would it be directed? A. To me.

Q. Did you receive a telephone call from Melvin J. Simmons of Construction Materials Company on or about December 10, 1956? A. No, sir.

Mr. Carr: That is all.

Cross Examination

Q. (By Mr. Catlin): Have you ever had a telephone call from Mr. Simmons? A. No, sir.

Q. You have never talked to him? [218]

A. No, sir.

(No further questions indicated.)

(Witness excused.)

Mr. Carr: That concludes the Apache Powder Company case, if the Court please.

We at this time ask for an amendment of the amended complaint to conform to the evidence.

First, showing in each instance in the amended complaint that the date of the termination of the Pioneer subcontract of the execution of Construction Materials contract was January 8, 1957, and second, that oral notice was given to the prime contractor on March 19, 1957 by Apache Powder Company within ninety days after the last material prior to January 8th, 1957 was furnished by Apache Powder Company on the Ajo job on December 20, 1956.

Mr. Johnson: At this time, your Honor, we object to the portion of the amendment which asks that it be amended saying oral notice was given to the prime contractor on the grounds the Miller Act doesn't provide for oral notice and that amendment would be completely immaterial.

The Court: Leave is given to make the first amendment in regard to allegation regarding the date of the subcontract by Construction and termination of the Pioneer contract. The balance of the motion is denied.

Mr. Lester: May I inquire, your Honor, if that is [219] on the basis of—

The Court: On the grounds it is immaterial.

Mr. Lester: On the basis of some other decision that oral notice can never comply with—in accordance with the Statutes?

The Court: Yes.

Mr. Lester: We would like an opportunity at some time to submit authorities to the Court on that point where it has been held sufficient.

The Court: I know of no case except the case in the Fifth Circuit where the Court on the basis of

one of its earlier decisions indicated that it would be possible to give or to comply with the Miller Act by the giving of oral notice, but that has been disapproved in the Ninth Circuit in the case in which I wrote the opinion. The case that I refer to in the Ninth Circuit is Bowden against Malloy, decided about a year ago.

Mr. Johnson: At this time, your Honor, the third party defendant moves for judgment—or it should be the defendant at least, or the third party defendant—moves for judgment against the plaintiff Armco Drainage Company for the reason that their evidence has failed to support the allegations of their complaint and has failed to prove any cause of action against the original defendant, and hence by subrogation against the third party defendant, and [220] I wish to make the same motion for judgment against the plaintiff Apache Powder Company for the reason the evidence has failed to sustain their allegations, failed to disclose any cause of action against the defendant Ashton-Mardian Company or against the third party defendant, and for the further reason that the evidence as presented by the plaintiff Apache Powder Company affirmatively shows that taken in its most favorable light to them, that a contract between a new subcontract between the prime contractor and Construction Materials was finally executed on January 8th, 1957, that the last delivery of materials prior to the execution of said new subcontract was on or about December, 1957—on or about December 20, 1956, that their notice was not given until April 25, 1957,

which was well beyond the ninety days from either of those dates, and further that their own evidence shows that either they had actual notice in December of 1956 of the change of subcontractors, or if they did not have actual notice, they did have notice of facts sufficient to a reasonable man on inquiry, where reasonable inquiry would have discovered the true state of affairs.

Do you care to hear argument at this time, your Honor?

The Court: No.

Mr. Catlin: For the purpose of the record, the defendant Ashton-Mardian joins in the motion made by Mr. Johnson. [221]

The Court: Very well. I will reserve ruling on both motions.

Mr. Johnson: I will call Mr. Swagerty.

PAUL A. SWAGERTY

called as a witness herein, having been first duly sworn, testified as follows:

Direct Examination

Q. (By Mr. Johnson): Please state your name.

A. Paul A. Swagerty.

Q. Where do you live?

A. 3168 North Romero Road, Tucson.

Q. What is your occupation?

A. Construction superintendent.

Q. By whom are you employed at the present time?

A. Construction Materials, Construction Division.

(Testimony of Paul A. Swagerty.)

Q. By whom were you employed during the year 1956?

A. I was hired by Tommy Moore of the old Pioneer organization and later was rehired by Joe Skorpick for Construction Materials, Construction Division.

Q. In what capacity did you work for Pioneer Constructors during the portion of the year 1956 when you were employed by that company? [222]

A. In what capacity?

Q. Yes.

A. As construction superintendent.

Q. Where?

A. At the Ajo Radar Base.

Q. That is the Ajo job we have been discussing in this case? A. Yes.

Q. You have been in the courtroom during the trial of this case and heard the preceding evidence?

A. Most of it.

Q. Do you recall the approximate date on which your employment by Pioneer terminated and you became associated with Construction Materials?

A. Well, it was sometime in October of '56 that Mr. Skorpick and some representative of Pioneer whom I don't know except for one man I had occasion to meet before, Curtis Catrin, called at the Ajo job for the purpose of determining what portion of the work had been done at that time.

Q. Did they advise you at that time from then on you were to be employed by Construction Materials?

(Testimony of Paul A. Swagerty.)

A. Mr. Skorpick advised me I think the following week, but he told me at that time there would be a change. That is why these people were there.

Q. And the following week it was that the change had been [223] made, is that right?

A. My pay check came out Construction Materials, Construction Division. He actually told me at the time there would be a change and asked me to stay on if I would.

Q. Did you hear the testimony of Mr. Negley who testified a little while ago? A. I did.

Q. Did you hear his testimony in regard to a telephone conversation with you on or about the 4th day of December, 1956? A. I did.

Q. Did you have a conversation with him on that day?

A. Well, I don't know. It has been too long ago to pinpoint a date, but I had numerous conversations with Mr. Negley and if the record shows there was an order placed at that date by me, I would say that was correct.

Q. Do you recall a conversation on or about that time in which the matter of billing was discussed, whether or not it should be billed to Pioneer or Construction Materials? A. I do.

Q. Could that have been on or about the time Mr. Negley mentioned? A. I think so.

Q. Tell the Court the substance of that conversation.

A. Well, to regress, Mr. Simmons had called me sometime [224] prior to this conversation and

(Testimony of Paul A. Swagerty.)

asked me that it wasn't just with regard to Apache Powder, it was with regard to any suppliers that we might have dealings with, which were few, and that I remind everyone that the bills should be submitted to Construction Materials, Construction Division, so I took this opportunity to tell Mr. Negley.

Q. Will you tell us as near as you can just what you said and what he said on that occasion? This is a long time and you can't recall the exact words, but if you can give us the substance.

A. At first I told him that future billings with regard to the Ajo work should be billed to Construction Materials, Construction Division. I don't know, I think at the time he asked me with regard to addresses, I told him that he could forward the statements to the same place that he had the previous ones; that Mr. Simmons would take care of them.

Q. Do you recall anything being said about them as to the status of Construction Materials Company, whether it was or was not a division of Pioneer Constructors Company?

A. No, I don't, because I didn't know. I am a construction superintendent. I don't know what affiliates the firm has or don't have.

Q. To the best of your knowledge did you ever make a statement to Mr. Negley or anyone else that Construction Materials Company was a division of Pioneer Constructors? [225]

A. I have not.

Mr. Johnson: That is all.

(Testimony of Paul A. Swagerty.)

Cross Examination

Q. (By Mr. Lester): You have just told us that you didn't know what the exact relationship was between the two companies at that time?

A. No. I had no way of knowing.

Q. It is entirely possible, isn't it, that you may have said something about the relationship, which you thought may have been the relationship between the two companies at that time?

A. As I remember it, since the mail and everything was handled through the same office, I think I made mention to him that the bills should be submitted to the same channels. What he made out of that, I don't know, but as far as what I—the contact I had with Tucson 130 miles away, our payrolls et cetera went through the same channels.

Q. But the point is you did not then know what the situation was between the two companies, isn't that true?

A. I know that I drew my check or was drawing my check from Construction Materials, Construction Division.

Q. Isn't it true at that time you did not know exactly the relationship between those two companies? [226]

A. No, I don't—I don't think I know anything of the Company policy even to this date.

Q. That would be more true then than today, isn't that correct?

A. The only thing I know about the people are the ones that hire me and the ones I work for.

(Testimony of Paul A. Swagerty.)

Q. Isn't that true that you knew less about the relationship between those two companies than you do now?

A. I don't know anything of the relationship now.

Q. It is entirely possible you may have said something that caused Mr. Negley to jot down the notation he did about your conversation?

A. I am not denying. He could have.

Mr. Lester: That is all.

Cross Examination

Q. (By Mr. Thompson): Mr. Swagerty, I believe you heard the testimony of Melvin J. Simmons that he received a call from you advising him that in relation to the Armco shipment of metal pipe to the Ajo job, that one of the shipments made probably in the month of October, 1956, did not contain all of the materials ordered, is that correct? A. That is correct.

Q. You asked Mr. Simmons then to see if he could order [227] the balance of those materials?

A. We were in dire need of them and I told him to get them there.

Q. At the time you had this conversation with Mr. Simmons, you knew, did you not, that those materials which you were requesting Mr. Simmons to order were a part of the materials which had been, which were a part of the order signed by the Pioneer Constructors in April, 1956?

A. I wouldn't know about that, but I do know

(Testimony of Paul A. Swagerty.)

they were short on one of your last loads, on your truck deliveries and I knew your truck driver made a memorandum or waybill on it and we didn't receive it, so I asked Mel to check on it. We knew we were short and the material was on order.

Q. You knew it was a Pioneer order?

A. Yes. At that time it would have been.

Mr. Thompson: That is all.

Cross Examination

Q. (By Mr. Catlin): Mr. Swagerty, you mentioned that Mr. Simmons had instructed you as regards to all your suppliers, to ask them to bill Construction Materials for future orders, is that correct?

A. Not Construction Materials; Construction Materials, Construction Division. [228]

Q. Did you do that? A. I did.

Q. With all of your orders from there on out?

A. Well, no. As Mr. Negley testified, we handled a lot of telephone conversations, we never did meet but we knew one another pretty well and I simply stated from here on out because he knew if he got a call from Ajo and from me it was for that project. We never went through the formality of stating firm names, project numbers.

Q. They said, "Mr. Swagerty, send out 28 cases of powder"?

A. That's exactly right, or whatever my necessity was. It usually called for more than that because the boy had scheduled it.

(Testimony of Paul A. Swagerty.)

Q. How about your other materials which you would order, or were there any other type of materials you would order?

A. There was no other I ordered other than local, automotive parts, and a service station account, things like that. The rest of the materials were all handled through the Tucson office. We did not have an accounting office set up at Ajo.

Q. As far as you were concerned, from some where around the first week in November, you were an employee of Construction Materials, Construction Division, is that correct? A. I was.

Q. And you were not an employee of Pioneer?

A. That is correct.

Q. Did that situation apply to all of the other employees at Ajo who had been?

A. All under my jurisdiction.

Q. Did you ever receive any inquiry from a representative of Apache Powder on the job in Ajo as to who was on the job, Pioneer or Construction Materials, or any inquiry regarding it?

A. Not to my knowledge. Their representatives called on us from time to time, but I don't remember specifically of anybody being there or could have been there.

Q. Did anybody inquire of you?

A. Nobody inquired of me that I can remember or recall at this time.

Mr. Catlin: No further questions.

Recross Examination

Q. (By Mr. Lester): I am curious to know the

(Testimony of Paul A. Swagerty.)

distinction you have just given between Construction Materials Co. and Construction Materials Co., Construction Division. Apparently there is some distinction. I noticed it in your testimony. Can you explain it?

A. Well, as I understood it from Mr. Skorpick, the Construction Division was not organized until they took over the balance of the Ajo job. Prior to that time it had been [230] a supplier of aggregate and transit mix supplies. To my knowledge it never built a project in the field, so they established Construction Materials, Construction Division.

Q. How many other divisions are there?

A. None that I know of. That is the one.

Q. How many have there been in the past?

A. I don't know about that. I worked for Pioneer Constructors and I worked for Construction Materials, Construction Division. There is Construction Materials with which I have nothing to do with that supplies transit mix and aggregate to various jobs.

Q. As far as you know there is a distinction between Pioneer, Construction Materials and Construction Materials, Construction Division?

A. That is the way I take it.

Q. But you are not quite sure? A. What?

Q. You are not quite sure what the distinction is?

A. I am sure of the firm I am working for, Construction Materials, Construction Division.

(Testimony of Paul A. Swagerty.)

Q. Do you contend, Mr. Swagerty, that when you made this telephone call in December, 1956, that you at that time notified Mr. Negley that there was a change in the subcontract on this job?

A. I wouldn't put it that way, no. [231]

Q. As a matter of fact, there was no change at that time, was there?

Mr. Johnson: I object to that question as conclusion of this witness. The witness testified he doesn't know the difference between those companies.

Mr. Lester: This question goes to as far as he knows.

A. As far as I know, as I have testified, I was working for Construction Materials, Construction Division. What the policy was, the contract written, the subcontract written, I know nothing about. I know the people that paid me.

Q. (By Mr. Lester): You didn't know what the status of the subcontract was on that job at that time? A. I had no occasion to know.

Q. Did you ever know at a later date?

A. What the subcontract was?

Q. What the status was at all times if and when it changed?

A. I know this much, that a contract must have changed hands or the people wouldn't have committed themselves to finish the job.

Q. But you don't know when it changed hands?

A. I had no occasion to know. Probably the time they changed my check.

(Testimony of Paul A. Swagerty.)

Q. You couldn't have told Mr. Negley that?

A. Couldn't have told him what? [232]

Q. About the change, because you did not know when it was or that there was going to be one?

A. I was just following out instructions from the Tucson office with regard to billing.

Q. The most you told Mr. Negley then, the most you claim you told him was to make a change in the form of billing?

A. I told him henceforth shipments to Ajo should be billed Construction Materials, Construction Division.

Q. With regard to Apache's Exhibit No. 4, Mr. Swagerty, will you take a look at an invoice which is dated January 17, 1957 and take a look at the bottom where it says Pioneer Constructors. Can you tell me if that is your signature?

A. That is.

Q. In other words, you receipted for the shipment of materials described in that invoice?

A. I did.

Q. You received the materials on the job and signed that invoice?

A. That's right.

Q. Underneath Pioneer Constructors, true?

A. True. All I looked at is 28 cases delivered.

Q. This isn't the only one you signed?

A. No.

Q. You signed a great many of these over the entire project, had you not? [233]

A. I don't know how many. It usually piles up on a mountain some place out of reach. If I

(Testimony of Paul A. Swagerty.)

was two or three miles up on the mountain and it would take an hour for me to get down and Apache's truck come in, the boys, Mr. West, would, or he would assign one of his assistants to help unload the truck. That was a common courtesy, and they receipted for the material when they got it.

Q. You are familiar with the form?

A. Anybody is familiar with the form of bill of lading, but I was interested if I got 25 cases of powder and explosives. That is what I was most concerned with.

Mr. Lester: That is all.

(No further questions indicated.)

The Court: Do you want to excuse this witness?

(No objections indicated.)

(Witness excused.)

Mr. Johnson: We rest, your Honor.

The Court: Is there anything further?

Mr. Thompson: If the Court please, in Plaintiff Armco's complaint on page 3 thereof, I don't know whether this is too important in view of the stipulations that have been made, but in view of the notice indicating the unpaid balance which Mr. Sturm sent to the Ashton-Mardian Company, in paragraph 8, line 4, inadvertently it says during the month of October, and I move the Court to amend that to [234] August at this time. It says October to December. It should be August to December.

The Court: The complaint may be so amended.

Mr. Johnson: Your Honor, at this time we renew our motion for judgment in both cases on the grounds previously stated.

Mr. Lester: We move for judgment on our complaint, if the Court please.

Mr. Thompson: Defendant Armco moves for judgment on its complaint.

The Court: The motion of Armco will be granted.

To me it is clear in their case they did furnish the materials to Pioneer as a subcontractor on the Ajo job; that the last of the materials was furnished on December 17, 1956, and that a notice to the prime contractor complying with the terms of the Miller Act, written notice was given to the prime on the 12th day of March, 1957, within the ninety days.

The motion of Armco for judgment against Pioneer and the prime and the Travelers Indemnity will be granted.

In the other matter, the other case, the thing that gives me question is whether or not Apache had notice or was charged with notice by the early part of January, that the materials furnished after December 4 were actually furnished to Constructors so that they were furnished to a different—a person other than the subcontractor Pioneer, therefore, [235] whether or not their April 25th notice was within the ninety days.

I want to look at some of the exhibits on that to satisfy myself, and on that will determine the decision as to whether or not Apache is entitled to

recover. According to my present views, if they were not on notice or charged with notice by that early date in January at a time before the 15th of January, then I think they would be entitled to judgment, but if they were on notice or charged with notice, then notice under the Miller Act wasn't given at the proper time as to the written notice in April.

Mr. Catlin: Does your Honor wish any argument on this?

The Court: I have a feeling right now, but I want to take a more careful look at the exhibits. That is the situation. I don't think argument will change it any. I have a conviction about it. I just want to study the exhibits again. I looked at them in passing and I want to take a better look at them.

Mr. Catlin: I would like to make one observation.

The Court: I am always open to that.

Mr. Catlin: The observation I would like to make is that, first, that for either of these plaintiffs to recover, we will take Apache, is under the Miller Act, and the Miller Act alone is what gives them the right to recover as far as [236] the Miller Act is concerned.

The Court: And the surety.

Mr. Catlin: And the surety. Therefore, we have to look to the Miller Act in this case solely. I believe I am correct.

The Court: That is right.

Mr. Catlin: The only notice under the circum-

stances, there is no assertion that this supplier had any direct dealings with the prime at all. So they fall down under the second portion which requires that the notice and the only provision in there as to notice is a notice not running from the prime to the supplier, but a notice running from the supplier to the prime. And certain things your Honor said this morning, I don't want your Honor to get his eye off the ball at all as to what notice is called for under the Miller Act.

The Court: The notices I see in the case of Armeo are in your letter of March 11 and the notice I see here from Apache is the letter of April 25th, a registered letter. Are those the ones you think I should keep my eye on?

Mr. Catlin: The thing I was worried about and am worried about is a conception in your Honor's mind of putting a duty onto the prime to notify all of the suppliers of all of the subs at any time when the job is either stopping or where he has by reason, one reason or another, fired a [237] subcontractor or for any other reason that a subcontractor goes off the job. That is the thing that—

The Court: I think there may be an estoppel on the part of the prime and therefore against the surety under certain circumstances. I don't believe a case like this ever happened before. I hope it never will happen again.

Mr. Catlin: It never will with anybody sitting in this room.

The Court: But I have no authority for feeling that there could be an estoppel, but if I find the

facts will warrant it, I wouldn't hesitate to base a judgment on the estoppel theory.

Mr. Catlin: One other observation that was on the law, and that is this, that in taking the testimony of Mr. Ashton, Mr. Simmons and Mr. Swagerty, it would appear that this is what happened: That as far as Construction Materials and Pioneer are concerned, and their various ramifications which we the prime do not know anything about, or did not know anything about, they among themselves made a change on the job not apparent to the prime at that point and not apparent to the supplier, which until the last of November, at which time they at that point apparently had made the—got up nerve enough or something else, to approach the prime to see if he would agree to the change, and which under certain circumstances and certainly under the circumstances that Mr. [238] Ashton pointed out: Can't see how it will hurt us, so you have our permission to go ahead, all of which was formalized, I believe the word Mr. Ashton used, formalized by the actual execution of the contract and the issuance of the Hartford bond at a later date, however, as between the Pioneer and Construction Materials. That change had taken place as far as their dealings are concerned, and if it had been done correctly by them, by those people, it would have been that change as among the suppliers would have been done at that time also because that is when they actually on the ground made the change. Whether the prime under your Honor's theory is charged with that, that of course is your Honor's decision. I wanted

to point out what I thought actually happened.

Mr. Johnson: One brief observation, your Honor. Your Honor stated that the crux of the matter is whether Apache had notice or was charged with notice. I won't discuss the exhibits because your Honor will refer to them, but I do want to point out and emphasize one point in Mr. Henderson's testimony I think should be given very great consideration in that respect, and that is when he stated on cross examination that, yes, he was concerned with all these facts as disclosed by those exhibits but they considered it very carefully and did make an investigation. The evidence shows they made a very inadequate investigation. They didn't talk to Skorpick, Ashton, anybody else that would know. Thereby [239] by his own admission he was on notice that there might be something going on and decided to make an investigation of it. I believe that is a fact that should be considered along with exhibits, that by Mr. Henderson's own admission, own statement, the way he considers this matter.

Mr. Lester: One brief observation. It seems to me defendants' defense in this case boils down to this: They say Mr. Apache on December 4th, we gave you enough of a hint as to what the underlying truth of the situation was, and had you employed your imagination and had you conducted a thorough investigation, you would have discovered the truth. Bear in mind, your Honor, that on December 4th there was no change in the subcontract, so what would we have found out had we exercised

our imagination and our diligence in conducting this investigation which I submit in the first place we were under no duty to do. We would have found out there was no change in the subcontracts. The most we could have found out at that time had the principals involved chosen to tell us the truth, was that one was contemplated and might eventually, depending upon certain contingencies, be executed. So, what would the result have been had we elected to act upon this December 4th hint? Had we elected to do business with the new subcontractor who was not yet the subcontractor, and then on January 8th for some reason the contract not changed because by the company or one thing and another did [240] not materialize as they expected, and had the situation remained the same, that is, had Pioneer remained the sub for one reason or another, then they could come in and say you jumped the wrong way. You elected to go with Construction Materials Company. You made a bad guess. We thought we were going to change subcontractors but we did not. You are therefore out under the Miller Act because ninety days expired. They say you didn't dream the truth and had you exercised your imagination you would have found out what was going on and would have been able to jump one way or the other and had you jumped the right way you would be okay, but we did not know which way to jump because that never developed until January 8th. It seems perfectly ridiculous to me to suggest that Apache who had no part in these negotiations with the sub and the prime was under an obligation

to play detective in the matter and find out what their imaginations were, when they themselves knew and could just as easily have told us instead of merely hinted to us in this manner by having an employee in the office call and say please change your billing. They knew we weren't changing it. We never did change it. They knew it all along, that it was never returned to us. They could have just as easily written a letter. That would have been the natural thing for any business man to do in the situation, was to write a letter and say we are going to change the situation and when changed to write and [241] tell us we have changed it. To me it is reminiscent of the old shell game, which one has the bean at which time.

Mr. Catlin: Your Honor, he speaks of "they". We don't want to be associated with Pioneer as far as the "they" is concerned. They owe the bill and should have paid it and we would like to see all suppliers get paid, but the "they", we don't want to be accused of.

Mr. Lester: I am not accusing the prime. The only thing about the prime is that they did have official oral notice as reflected by the written memorandum from Mr. Mardian to Mr. Ashton within the ninety days, and depending how your Honor rules, if your Honor continues to rule adversely to us on that point, then, of course, we have nothing to do but rely on our written formal notice of April 25th.

The Court: The plaintiff Armco will prepare findings of fact and conclusions of law and a judg-

ment. I will decide 967 in the next few days.

Mr. Catlin: We have another important step as far as the prime is concerned, that is our little difficulties with the third party defendant. So far in this case they have been on the same side. We now change parts of the fence. I would like to have your Honor's ideas as to how and when we should handle that portion of this matter.

The Court: It may take care of itself. You may not [242] be in any disagreement with Hartford. I realize there are issues to follow, but we will take care of this at this time and pick up the loose ends from there.

We will stand at recess. [243]

[Endorsed]: Filed June 3, 1958.

[Endorsed]: No. 16052. United States Court of Appeals for the Ninth Circuit. Apache Powder Company, a corporation, Appellant, vs. The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company and Mardian Construction Company, corporations engaged in a joint venture as Ashton-Mardian Company and The Travelers Indemnity Company, a corporation, Appellees. Transcript of Record. Appeal from the United States District Court for the District of Arizona.

Filed: June 18, 1958.

Docketed: June 18, 1958.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
For the Ninth Circuit

No. 16052

UNITED STATES OF AMERICA, for the Use
of APACHE POWDER COMPANY, a corporation,
Appellant,

vs.

THE ASHTON COMPANY, INC., CONTRACTORS AND ENGINEERS, formerly Ashton Building Company and MARDIAN CONSTRUCTION COMPANY, corporations engaged in a joint venture as Ashton-Mardian Company and THE TRAVELERS INDEMNITY COMPANY, a corporation,
Appellees.

CONCISE STATEMENT OF POINTS TO
BE RELIED ON BY APPELLANT ON
APPEAL

Appellant herein, United States of America, for the Use of Apache Powder Company, a corporation, intends to rely upon the following points for reversal of the judgment of the District Court:

1. The District Court erred in denying plaintiff Apache Powder Company's motion, made at the close of its case, for an amendment to the Amended Complaint to conform to the evidence, alleging that oral notice was given to the prime contractor, Ashton Mardian Company, on March 19, 1957, by Apache Powder Company within ninety (90) days

after the last material, prior to January 8, 1957, was furnished by Apache Powder Company on the Ajo job on December 20, 1956, for the reason that such proposed allegation conformed to the evidence, and was material in that such oral notice complies with the requirements of Act of Congress of August 24, 1935, c. 642 §2, 49 Stat. 794, 40 U.S.C.A. §270b(a).

2. The District Court erred in finding that the plaintiff Apache Powder Company did furnish materials to the subcontractor, Pioneer Constructors, from June 13, 1956, to and including the 31st day of October, 1956, at the special instance and request of the defendant Pioneer Constructors of a reasonable value of \$20,900.39, without at the same time finding that the last of the material furnished by plaintiff Apache Powder Company on the aforesaid Ajo radar station job, prior to January 8, 1957, the date when the subcontract of defendant Pioneer Constructors was formally terminated and a new subcontract formally entered into between Ashton-Mardian Company and Construction Materials Company, was on December 20, 1956, such additional findings being material and being required by the undisputed evidence on these points.

3. The District Court erred in finding that defendant Pioneer Constructors ceased the doing of any work on the aforesaid job on October 31, 1956, and Construction Materials Company did perform all work encompassed under the Pioneer Constructors' subcontract done on and after November 1, 1956, without at the same time finding that until January 8, 1957, Pioneer Constructors was held re-

sponsible and liable under its subcontract and bond to the prime contractor by Ashton-Mardian Company, the prime contractor, and that from and including November 1, 1956, to and including January 8, 1957, the work performed by Construction Materials Company on said job was performed under the same management, using the same office, employing substantially the same personnel and equipment, and obtaining its material and supplies from the same suppliers as had Pioneer Constructors prior to November 1, 1956, such additional findings being material and being required by the undisputed evidence on these points.

4. The District Court erred in finding that, on December 4, 1956, in the expectation that the defendant Pioneer Constructors' subcontract and the entry of Construction Materials Company into a subcontract would soon thereafter be formally accomplished, Construction Materials Company caused the plaintiff Apache Powder Company to be notified that all materials thereafter supplied or delivered by plaintiff Apache Powder Company to the aforesaid job were to be billed to Construction Materials Company, without at the same time finding that such notification was given by the person who previously had ordered the material for the Ajo job as an employee of Pioneer Constructors, that such person did not notify Apache Powder Company that he then was an employee of Construction Materials Company, and that such person then voluntarily stated that Construction Materials Company was a division of Pioneer Constructors, such additional

findings being material and being required by the undisputed evidence on these points.

5. The District Court erred in finding that after December 4, 1956, and not later than January 8, 1957, plaintiff Apache Powder Company had knowledge and information which would have led a reasonably prudent person in the same situation to make an investigation of the subcontract situation on the Ajo job and the relation of Pioneer Constructors and Construction Materials Company thereto, for the reason that Pioneer Constructors' subcontract had not been terminated on December 4, 1956, and plaintiff Apache Powder Company had no notice or knowledge until March 19, 1957, that Pioneer Constructors' subcontract had been terminated on January 8, 1957, and such findings are not supported by the evidence and are contrary thereto.

6. The District Court erred in finding that plaintiff Apache Powder Company failed to make any reasonable effort under the circumstances to ascertain the facts regarding the subcontract situation and the relationship of Pioneer Constructors and Construction Materials Company thereto; and that Apache Powder Company did not act with ordinary prudence in protecting its rights as against the prime contractor and its surety, for the reason that such finding is not supported by the evidence and is contrary thereto.

7. The District Court erred in concluding that the written notice given by plaintiff Apache Powder Company to defendant Ashton-Mardian Company

on April 25, 1957, did not comply with the requirements of Act of Congress of August 24, 1935, c. 642 § 2, 49 Stat. 794, 40 U.S.C.A. § 270b(a), for the reason that Apache Powder Company had no notice or knowledge until March 19, 1957, of the termination on January 8, 1957, of Pioneer Constructors' subcontract, and said written notice was given within ninety days after Apache Powder Company furnished the last of the material on said Ajo job on March 12, 1957, and said conclusion is not supported by the law and the evidence and is contrary thereto.

8. The District Court erred in concluding that the oral notice given by plaintiff Apache Powder Company to defendant Ashton-Mardian Company on March 19, 1957, given within ninety (90) days from December 20, 1956, on which date plaintiff Apache Powder Company furnished the last of the materials on said Ajo job prior to January 8, 1957, when Pioneer Constructors' subcontract was terminated, did not comply with the requirements of Act of Congress of August 24, 1935, c. 642, § 2, 49 Stat. 794, 40 U.S.C.A. § 270b(a), for the reason that said oral notice did comply with the requirements of said Act of Congress, and said conclusion is not supported by the law and the evidence and is contrary thereto.

9. The District Court erred in concluding that the plaintiff Apache Powder Company is not entitled to judgment against the defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian

Construction Company, corporations engaged in Joint Venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, or any of them, under the First Count of the Amended Complaint, and that said defendants are entitled to judgment against the plaintiff for their costs of suit, for the reason that such conclusions are not supported by the law and the evidence and are contrary thereto.

10. The District Court erred in ordering, adjudging, and decreeing that defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in Joint Venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, have judgment against the plaintiff on the First Count of plaintiff's Amended Complaint, and that plaintiff take nothing by said First Count from said defendants, or any of them, and that said defendants have their costs of suit, for the reason that such judgments are not supported by the law and the evidence and are contrary thereto.

Respectfully submitted,

EVANS, KITCHEL & JENCKES,
/s/ By ALFRED B. CARR,
Attorneys for Plaintiff.

Notice of Mailing Attached.

[Endorsed]: Filed June 18, 1958. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

DESIGNATION OF RECORD MATERIAL
TO CONSIDERATION OF APPEAL

Appellant herein, United States of America, for the Use of Apache Powder Company, a corporation, hereby designates all of the record which is material to the consideration of the appeal, numbering and setting forth the items in accordance with the Clerk's Certificate of Record on Appeal, dated June 16, 1958, as follows:

1. Complaint.
2. Answer of Defendants The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company and Mardian Construction Company, corporations engaged in Joint Venture as Ashton-Mardian Company.
3. Motion for More Definite Statement by third party defendant, Hartford Accident and Indemnity Company.
4. Plaintiff's Response to Third Party Defendant's Motion for More Definite Statement.
5. Answer of Defendant, Pioneer Constructors, a corporation.
6. Answer of Third Party Defendant to Plaintiff's Complaint.
7. Answer of Defendant, The Travelers Indemnity Company, a corporation.
8. All of the Transcript of Pre-trial Conference, except those portions relating solely to No. Civil 966, the case of Armco Drainage & Metal

Products, Inc., which excepted portions appear on
Lines 9 to 25, inclusive, page 4.

All of page 5.

Lines 1 to 10, inclusive, page 6.

Line 1, page 7.

All of pages 8, 9, and 10.

Lines 1 to 6, inclusive, page 11.

Lines 8 to 25, inclusive, page 16.

All of pages 17 and 18.

Lines 1 to 9, inclusive, page 19.

Lines 13-25, inclusive, page 26.

Lines 1 to 19, inclusive, page 27.

Lines 25 and 26, page 31.

All of pages 32, 33, and 34.

Lines 1 to 20, inclusive, page 35.

9. Minute entry of January 30, 1958 (pre-trial conference).

10. Minute entry of February 28, 1958 (order granting leave to file amended complaint and for separate trials).

11. First Count of Amended Complaint.

12. Minute entry of March 4, 1958 (proceedings of trial).

13. Minute entry of March 5, 1958 (further proceedings of trial).

14. Minute entry of March 6, 1958 (decision).

15. Proposed Additions to Findings of Fact and Conclusions of Law.

16. Objections to Proposed Additions to Findings of Fact and Conclusions of Law filed by defendants Ashton-Mardian Company and The Travelers Indemnity Company.

17. Minute entry of March 21, 1958 (settling findings of fact and conclusions of law and making additional findings of fact and conclusions of law).

18. Findings of Fact and Conclusions of Law.

19. Judgment.

20. Civil Docket Entry of Judgment of March 21, 1958.

21. Civil Docket Entry of Judgment of April 3, 1958.

22. Minute entry of April 3, 1958, for entry of judgment upon claim made by First Count of Amended Complaint.

23. Notice of Appeal to Court of Appeals from judgment entered March 24, 1958.

24. Plaintiff's Bond for Costs on Appeal relating to appeal from judgment entered March 24, 1958.

25. Plaintiff's Notice of Appeal to Court of Appeals from preliminary judgment entered March 24, 1958, and final judgment entered April 3, 1958.

26. Plaintiff's Bond for Costs on Appeal relating to appeal from preliminary judgment entered March 24, 1958, and final judgment entered April 3, 1958.

27. All of the Transcript of Proceedings, except the testimony relating solely to No. Civil 966, the case of Armco Drainage & Metal Products, Inc., which excepted portions are as follows:

(a) The testimony of William Johnson, appearing on pages 22 to 30, inclusive.

(b) The testimony of Gerald John Sturm, appearing on pages 30 to 42, inclusive, and pages

45 to 50, inclusive. [The testimony of Gerald John Sturm appearing on pages 43 and 44 is to be included.]

(c) The testimony of W. T. Melder, appearing on pages 96 to 102, inclusive.

28. Designation of Contents of Record on Appeal.

29. Concise Statement of Points to be Relied On by Appellant on Appeal.

Dated June 23, 1958.

EVANS, KITCHEL & JENCKES,
/s/ By ALFRED B. CARR,
Attorneys for Appellant.

Notice of Mailing Attached.

[Endorsed]: Filed June 25, 1958. Paul P. O'Brien, Clerk.

No. 16,052

United States Court of Appeals

For The Ninth Circuit

APACHE POWDER COMPANY, a
corporation.

Appellant,

v.

THE ASHTON COMPANY, INC.,
CONTRACTORS AND ENGINEERS,
formerly ASHTON BUILDING COM-
PANY, and MARDIAN CONSTRUC-
TION COMPANY, corporations
engaged in Joint Venture as ASH-
TON-MARDIAN COMPANY; and THE
TRAVELERS INDEMNITY COMPANY,
a corporation,

Appellees.

Appeal from the
United States Dis-
trict Court for the
District of Arizona

APPELLANT'S OPENING BRIEF

EVANS, KITCHEL & JENCKES
807 Title & Trust Building
Phoenix, Arizona
Attorneys for Appellant

FILED

AUG 27 1958

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United States Court of Appeals

For The Ninth Circuit

APACHE POWDER COMPANY, a
corporation.

Appellant,

v.

THE ASHTON COMPANY, INC.,
CONTRACTORS AND ENGINEERS,
formerly ASHTON BUILDING COM-
PANY, and MARDIAN CONSTRUC-
TION COMPANY, corporations
engaged in Joint Venture as ASH-
TON-MARDIAN COMPANY; and THE
TRAVELERS INDEMNITY COMPANY,
a corporation,

Appellees.

No. 16,052

Appeal from the
United States Dis-
trict Court for the
District of Arizona

APPELLANT'S OPENING BRIEF

JURISDICTION

The above-entitled proceeding arises upon an appeal from a judgment entered in an action by United States of America, for

the use of Apache Powder Company, a corporation, against The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in joint venture as Ashton-Mardian Company, The Travelers Indemnity Company, a corporation, and Pioneer Constructors, a corporation, brought under the Act of Congress of August 24, 1935, c. 642, § 2, 49 Stat. 794, 40 U.S.C.A. § 270b (Appendix 52), known as the Miller Act, on the payment bond of the contractor under a contract with the United States of America which was to be and was performed and executed within the District of Arizona.

The jurisdiction of the District Court rests upon the provision of said § 270b that every suit instituted under § 270b shall be brought in the name of the United States for the use of the person suing, in the United States District Court for the district in which the contract was to be performed and executed and not elsewhere, irrespective of the amount in controversy in such suit.

The District Court sitting without a jury separately tried the issues under the Miller Act between use plaintiff Apache Powder Company, appellant herein, and defendants Ashton-Mardian Company and the Travelers Indemnity Company, appellees herein, and defendant, Pioneer Constructors, a corporation, on the first count of the amended complaint praying for judgment for \$18,947.96, with interest and costs (R 45), answer of Ashton-Mardian Company (R 10), motion for more definite statement of Hartford Accident and Indemnity Company, the third party defendant (R 13), plaintiff's response to third party defendant's motion for more definite statement (R 15), answer of defendant Pioneer Constructors (R 16), answer of third party defendant to plaintiff's complaint (R 18), and answer of defendant The Travelers Indemnity Company (R 22), with the right of all parties to participate and to offer evidence within those issues (R 26).

The District Court ordered entry of a separate final judgment on the issues tried in favor of The Ashton Company, Inc., Con-

tractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in joint venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, and against United States of America, for the use of Apache Powder Company, a corporation, and judgment in favor of United States of America, for the use of Apache Powder Company, a corporation, and against Pioneer Constructors, a corporation, in the sum of \$18,947.96, with interest and costs (R 79), and the judgment from which appeal has been taken was entered on April 3, 1958 (R 79).

The judgment being final, the present appeal is predicted upon 28 U.S.C.A. § 1291.

STATEMENT OF THE CASE

On March 30, 1956, appellee Ashton-Mardian Company entered into a written contract (R 106), with the United States of America, Corps of Engineers, United States Army (Plaintiff Armco's exhibit 3 marked for identification), under which Ashton-Mardian Company agreed to furnish material and perform work for the construction and completion of Air Force Station TM-181, a radar station five miles North of Ajo, Arizona, in accordance with plans and specifications and terms and conditions therein specifically set forth, for \$2,351,637.00. [Alleged in paragraph III of amended complaint (R 45), and admitted in answers of Ashton-Mardian Company (R 10), Pioneer Constructors (R 16), Hartford Accident and Indemnity Company (R 18), and The Travelers Indemnity Company (R 22).]

On March 30, 1956, pursuant to Act of Congress of August 24, 1935, c. 642, § 1, 49 Stat. 793, 40 U.S.C.A. § 270a (Appendix 51), known as the Miller Act, and pursuant to the terms of said contract, appellee Ashton-Mardian Company, as principal, and appellee The Travelers Indemnity Company, as surety, executed and delivered to the United States of America their payment bond for \$940,655.04 (Plaintiff Armco's exhibit 3 marked for identification), the condition of which bond, as required by the

Miller Act, being that the principal shall promptly make payment to all persons supplying labor and material in the prosecution of the work provided in said contract. [Alleged in paragraph IV of amended complaint (R 45), and admitted in answers of Ashton-Mardian Company (R 10), Pioneer Constructors (R 16), Hartford Accident and Indemnity Company (R 18), and The Travelers Indemnity Company (R 22).]

Ashton-Mardian Company, as the prime contractor under said contract with the United States of America, entered into a subcontract with Pioneer Constructors (R 106) (Plaintiff Armco's exhibit 6 in evidence) dated March 30, 1956 (R 107), for the performance and completion of certain parts of the work under said prime contract, specified in said subcontract, in accordance with the plans and specifications and terms and conditions of said prime contract, for \$401,217.83. This subcontract applied principally to the construction of the roadway on the Ajo job (R 108, 109).

After the execution of its subcontract Pioneer Constructors, who had dealt with appellant Apache Powder Company for material for other jobs (R 186), and had an open account with Apache Powder Company (R 187), entered into an agreement with Apache Powder Company (R 186, 187), under which it was agreed that Apache Powder Company would furnish to Pioneer Constructors the material consisting of explosives and blasting supplies required by said subcontractor under said subcontract for use in the prosecution of the work under its subcontract and said prime contract with the United States of America, and Pioneer Constructors would pay for such material at the usual list prices less contractors' discounts, which were then known to said subcontractor (R 215).

From and including June 13, 1956, to and including March 12, 1957 (R 187), on an open account on a series of special orders (R 187), Apache Powder Company furnished material consisting of explosives and blasting supplies (Plaintiff Apache's

exhibit 3 in evidence) for use in the prosecution of the work specified in Pioneer Constructors' subcontract and in said prime contract with the United States of America, of the agreed and reasonable value of \$33,453.71 (Plaintiff Apache's exhibit 4 in evidence) (R 215, 216). Such material was delivered by Apache Powder Company on said radar station job (R 187), and was used in the prosecution of the work specified in Pioneer Constructors' subcontract and in said prime contract with the United States of America (R 32).

Beginning on June 13, 1956, said special orders for such material were given by Pioneer Constructors, and such material was billed, shipped, and delivered to Pioneer Constructors (Plaintiff Apache's exhibit 3 in evidence) (R 188), and charged to Pioneer Constructors on its open account (Plaintiff Apache's exhibits 4 and 5 in evidence) (R 192). Paul A. Swagerty, who was construction superintendent for Pioneer Constructors and later for Construction Materials Company (R 249, 250), ordered most of such material, phoning the orders to Apache Powder Company at its office at Benson, Arizona (R 239). Paul Negley, the shipping clerk and billing clerk in the accounting department of Apache Powder Company (R 238), received most of said orders, and received a number of them from Paul A. Swagerty (R 239).

During the latter part of November, 1956 (R 112), without any notice or knowledge thereof by Apache Powder Company (R 200, 201), Pioneer Constructors and Construction Materials Company, with J. E. Skorpick and Thomas E. Moore representing both companies, and Ashton-Mardian Company agreed that Construction Materials Company would take over the subcontract of Pioneer Constructors on said Ajo job as of November 1, 1956 (R 112, 117), on two conditions. Construction Materials Company had previously been engaged in the construction materials business, and had done no construction work (R 257), and Ashton-Mardian Company required that the work proceed under the same management, and with the same personnel and equipment as under the Pioneer Constructors subcontract (R

132). The second condition was that Construction Materials Company execute and deliver to Ashton-Mardian a new subcontractor's bond, with acceptable surety, preferably the same as the surety on the Pioneer Constructors bond, for performance and payment under Construction Materials Company's subcontract (R 123).

Thereafter a subcontract (Plaintiff Armco's exhibit 7 in evidence) from Ashton-Mardian Company to Construction Materials Company was prepared, dated November 1, 1956, and signed by Construction Materials Company, but not executed and delivered by Ashton-Mardian Company until January 8, 1957 (R 124, 125), when Construction Materials Company's subcontractor's bond to Ashton-Mardian Company was executed and delivered to Ashton-Mardian Company. The subcontract to Pioneer Constructors was terminated at the same time (R 125). Apache Powder Company had no notice or knowledge of the termination of the subcontract to Pioneer Constructors or the execution and delivery of the subcontract to Construction Materials Company at that time, and did not learn thereof until March 19, 1957 (R 200, 201), after Apache Powder Company had delivered the last of such material on the Ajo job on March 12, 1957 (R 187).

In the meantime, beginning November 4, 1956, Construction Materials Company took over the payroll (R 158, 161), and the work specified in the Pioneer Constructors subcontract which had not then been completed, which was estimated as of October 31, 1956, to amount to \$266,391.66 (R 120, 131). This was done before J. E. Skorpick and Thomas E. Moore, representing Construction Materials Company, approached Harold Ashton in the last half of November, 1956, for a new subcontract to Construction Materials Company (R 112). After the agreement with Ashton-Mardian Company for a new subcontract, Construction Materials Company's taking over the work was subject to the requirement by Ashton-Mardian Company that a new subcontractor's payment and performance bond, with acceptable surety, be furnished by Construction Materials Company to Ashton-Mardian Company, and Ashton-Mardian Company held Pioneer

Constructors liable and responsible on its subcontract and bond until the execution and delivery of the Construction Materials Company subcontract and bond on January 8, 1957, and Ashton-Mardian Company made no payments to Construction Materials Company until after the new bond was furnished (R 125, 126).

In Section 1 on the face of the Pioneer Constructors subcontract (Plaintiff Armco's exhibit 6 in evidence) see Appendix 53, and in Section 1 on the face of the Construction Materials Company subcontract (Plaintiff Armco's exhibit 7 in evidence) see Appendix 56, the work specified to be performed is identical (R 116, 128). The supplemental sheets attached to the subcontracts show that the items to be performed are identical, (with the exception of Item 30 which had been completed by Pioneer Constructors), and the unit prices are identical, the differences being in the quantities to be performed or supplied, the extensions of the amounts, and the total (R 128). Pioneer Constructors' subcontract is No. 7 and Construction Materials Company's subcontract is No. 128, but the supplemental sheet attached to the Construction Materials Company subcontract is entitled "Supplemental Sheet to Subcontract No. 7" (R 119).

In completing the work originally specified in Pioneer Constructors' subcontract, as required by Ashton-Mardian Company, Construction Materials Company used the same offices as Pioneer Constructors (R 149), operated under the same management, took over the payroll (R 158) and employed substantially the same personnel, and used substantially the same equipment (R 120). The name of Pioneer Constructors was on some of the equipment, and the name of Construction Materials Company did not appear on any of the equipment until after the first of the year 1957 (R 121, 122).

Apache Powder Company had no notice or knowledge of this change-over from Pioneer Constructors to Construction Materials Company in the performance of the work until March 19, 1957 (R 200, 201), after it had delivered the last of the material on the Ajo job on March 12, 1957 (R 187).

During the period it was furnishing material for use on the Ajo job, Apache Powder Company through its field engineers periodically visited the work and checked on its progress (R 201). These field engineers were there to do the servicing required by the contractor, watch the progress of the work, the personnel, and the equipment, and to watch particularly to determine when the job was nearing completion (R 201, 202). The field engineers reported that the work was progressing without any interruption in the schedule, and without any change in management, personnel, or equipment (R 215), and Apache Powder Company continued to supply powder and blasting supplies on the job (R 215).

Apache Powder Company had not received any payments from Pioneer Constructors for the material furnished prior to November 1, 1956 (R 220), and was aware of this situation (R 224). It was not the policy of Apache Powder Company to let accounts run without payments for several months, but it was not unusual with this type of work with contractors (R 228, 229). It didn't like to go to the prime contractor and embarrass the subcontractor, if it could be avoided. It had men in the field who watch the jobs, and they reported nothing unusual. It relied on the payment bond of the prime contractor in all cases of contract work (R 229). There is a competitive angle in the industry, and it is customary to go along with the contractors who do not pay regularly. If Apache Powder Company were to be too rigid and inflexible, it would lose a lot of business because its competitors will be liberal and in many cases more liberal (R 231).

Upon the receipt of an order, the procedure followed at the office and plant of Apache Powder Company was as follows: The billing and shipping clerk prepares a factory order, copies of which were distributed in the office and plant, and a copy mailed to the purchaser (R 187). This factory order is the form of record and acknowledgement of the order (R 187). Then the bill of lading for the shipment is prepared, with a form at the bottom for the receipt by the purchaser of the shipment, and the bill of lading is forwarded with the shipment (R 192). Then an invoice of the

order is prepared, a copy mailed to the purchaser (R 192), and a copy sent to the accounting department from which the account of the purchaser is charged. Then monthly statements of the account are sent to the purchaser (R 197).

On December 4, 1956, Paul A. Swagerty phoned to Paul Negley at the Apache Powder Company office in Benson, Arizona, giving an order for some material (R 240). Paul Negley testified (R 240), that he made a pencilled note of the contents of the conversation, the statements made, which is the first pencilled sheet attached to the factory order of December 4, 1956, one of the factory orders of Plaintiff Apache's exhibit 3 in evidence. Paul Negley further testified (R 240, 241):

Q. What generally does that pencilled note contain?

A. It generally contains the material that the customer wishes to have delivered.

Q. At the top left hand side appears the words, "Construction Materials Company, Construction Division, Tucson, Arizona." Do you recall the purpose of that notation?

A. Yes. Mr. Swagerty informed me upon giving me this order that the balance of the materials for the Ajo job should (210) be billed to Construction Materials Company, Construction Division, Tucson, Arizona, and that this division, this company is a division of Pioneer Constructors.

Q. Down below you have, there is a statement: "Above is division of Pioneer Constructors," with the address. You made that as a notation from Mr. Swagerty's statement?

A. Yes, sir.

Upon cross examination by Mr. Catlin, Paul Negley testified (R 243):

Q. This about the above is a division of Pioneer Constructors, you are positive Mr. Swagerty told you this and this wasn't an assumption on your part?

A. I am positive Mr. Swagerty told me that.

Paul A. Swagerty, testifying about the conversation with Paul Negley on December 4, 1956, said (R 252):

Q. Will you tell us as near as you can just what you said and what he said on that occasion? This is a long time and you can't recall the exact words, but if you can give us the substance.

A. At first I told him that future billings with regard to the Ajo work should be billed to Construction Materials, Construction Division. I don't know, I think at the time he ask me with regard to addresses, I told him that he could forward the statements to the same place he had the previous ones; that Mr. Simmons would take care of them.

Q. Do you recall anything being said about them as to the status of Construction Materials Company, whether it was or was not a division of Pioneer Constructors Company?

A. No, I don't, because I didn't know. I am a construction superintendent. I don't know what affiliates the firm has or don't have.

Q. To the best of your knowledge did you ever make a statement to Mr. Negley or anyone else that Construction Materials Company was a division of Pioneer Constructors? (225)

A. I have not.

Upon cross examination by Mr. Lester, Paul A. Swagerty testified (R 253) that he didn't know and had no way of knowing about the relationship between the two companies, but finally testified (R 254):

Q. It is entirely possible that you may have said something that caused Mr. Negley to jot down the notation he did about your conversation?

A. I am not denying. He could have.

Upon cross examination by Mr. Catlin, Paul A. Swagerty testified (R 255) that he did not ask that the orders be billed to Construction Materials Company on any of the later orders.

Upon further cross examination by Mr. Lester, Paul A. Swagerty made a distinction between Construction Materials Company and

Construction Materials Company, Construction Division, testifying (R 256, 257):

Q. (By Mr. Lester): I am curious to know the distinction you have just given between Construction Materials Co. and Construction Materials Co., Construction Division. Apparently there is some distinction. I noticed it in your testimony. Can you explain it?

A. Well, as I understood it from Mr. Skorpick, the Construction Division was not organized until they took over the balance of the Ajo job. Prior to that time it had been (230) a supplier of aggregate and transit mix supplies. To my knowledge it never built a project in the field, so they established Construction Materials, Construction Division.

Q. How many other division are there?

A. None that I know of. That is the one.

Q. How many have there been in the past?

A. I don't know about that. I worked for Pioneer Constructors and I worked for Construction Materials, Construction Division. There is a Construction Materials with which I have nothing to do with that supplies transit mix and aggregate to various jobs.

Q. As far as you know there is a distinction between Pioneer, Construction Materials and Construction Materials, Construction Division?

A. That is the way I take it.

Q. But you are not quite sure?

A. What?

Q. You are not quite sure what the distinction is?

A. I am sure of the firm I am working for, Construction Materials, Construction Division.

Paul A. Swagerty did not testify that he told Paul Negley there had been a change in the subcontract (R 258), and his final statement regarding the conversation with Paul Negley was (R 259):

Q. The most you told Mr. Nagley then, the most you claim you told him was to make a change in the form of billing?

A. I told him henceforth shipments to Ajo should be billed Construction Materials, Construction Division.

Melvin J. Simmons, who had been office manager and assistant secretary for Pioneer Constructors (R 148) and later was office manager, secretary, and treasurer of Construction Materials Company, also testified to a telephone conversation to someone at Apache Powder Company about billing to Construction Materials Company. He said he called on or about December 10, 1956 (R 165), and does not recall any other conversation on the subject (R 166). He testified (R 166, 167):

Q. Who did you ask for when the girl answered?

A. I asked for the bookkeeping or accounting department.

Q. Please state the substance of that conversation.

A. I explained to them that the powder being sent to Ajo should have been billed to Construction Materials because they were doing the work. I would appreciate it if they would bill it to Construction Materials. And as I recall he told me, "Pay these by invoice and get it straightened out," and that is all I remember of the conversation.

Q. Did you pay it by invoice after that?

A. Yes, sir.

* * * * *

Q. Did you at any time to your best recollection ever represent to anyone connected with Apache Powder or to anyone (126) else that Construction Materials Company was a division of Pioneer Constructors, or words to that effect?

A. I did not, no.

Robert L. Henderson, general manager of Apache Powder Company (R 185), when informed that Melvin J. Simmons had testified on the taking of his deposition that he had made a phone call to Apache Powder Company on or about December 10, 1956, regarding billing to Construction Materials Company, made an investigation to determine if such a call had been made, and said that no such call had been made (216). He further said (R 218)

that if a call came to the accounting department of Apache Powder Company, it would be referred either to the secretary-treasurer, Mr. Schmalzel, or in his absence the assistant secretary-treasurer, Mr. Browning, and that as calls come through the switchboard they would be directed to the proper place. (Note: The name of the secretary-treasurer is J. L. Schmalzel. It is consistently spelled throughout the transcript as Schmalzer.) J. L. Schmalzel also testified (R 245) that a call to the bookkeeping or accounting department would be directed to him, or in his absence to Amos J. Browning, his assistant, and J. L. Schmalzel (R 244) and Amos J. Browning (R 246) testified that they did not receive the phone call of which Melvin J. Simmons testified.

In further examination in regard to the phone call on December 10, 1956, to Apache Powder Company, Melvin J. Simmons testified (R 179) that he didn't know whether he called the purchasing department or the accounting department, that he did not ask the name of the person to whom he talked, and that he did not ask the capacity with the company of the person to whom he talked.

In this connection it is noted that Melvin J. Simmons also testified (R 171, 172) to a conversation on or about December 10, 1956, with Gerald John Sturm of Armco Drainage & Metal Products Company, in which Melvin J. Simmons testified he said Construction Materials Company was on the job on December 10, 1956. Gerald John Sturm testified (R 105) that he had a conversation with Melvin J. Simmons on December 10, 1956, but denied that Melvin J. Simmons said that Construction Materials Company had taken over the job and at that time was subcontractor on the job and that Pioneer Constructors was no longer on the job.

Apache Powder Company's version of the testimony of Melvin J. Simmons is that he did not call on December 10, 1956, and that if he did the most he claims is that he requested that future orders be billed to Construction Materials Company, because it was

doing the work. Apache Powder Company's version of the conversation of December 4, 1956, between Paul A. Swagerty and Paul Negley is that Paul A. Swagerty requested future billing to Construction Materials Company, and also stated that Construction Materials Company, Construction Division, was a division of Pioneer Constructors.

Immediately afterward Paul Negley reported this phone conversation with Paul A. Swagerty to J. L. Schmalzel (R 242), who then was the assistant secretary and assistant treasurer of Apache Powder Company (R 238), and then the conversation was reported to R. L. Henderson, the general manager of the company (R 185). Thereafter Apache Powder Company continued to bill and ship the material to Pioneer Constructors (R 213). The arrangements for supplying explosives and loaning magazines had been made with Pioneer Constructors, the subcontractors on the job. Apache Powder Company had no notice that the subcontract with Pioneer Constructors had been terminated. Apache Powder Company had not been approached by Construction Materials Company, and had no arrangements with it for sale or delivery of explosives or for loan of magazines. The invoices to Pioneer Constructors were not returned for correction. There were no objections from Pioneer Constructors or Construction Materials Company to the continued addressing of shipments to Pioneer Constructors. (213) Apache Powder Company believed it was delivering the material to Pioneer Constructors under the Pioneer Constructors contract of March 30, 1956 (R 214).

Apache Powder Company made the factory order for the material ordered by Paul A. Swagerty by phone on December 4, 1956, to Pioneer Constructors, and billed, shipped, and charged it to Pioneer Constructors, and thereafter continued to bill, ship, and charge all the orders to Pioneer Constructors (Plaintiff Apache's exhibits 3 and 4 in evidence). All these orders were received from Paul A. Swagerty (R 240).

The December 4, 1956, order, and all subsequent orders were

receipted for on the bill of lading in the name of Pioneer Constructors (Plaintiff Apache's exhibit 4 in evidence).

On December 29, 1956, Apache Powder Company received a check dated December 27, 1956, for \$4,723.37, from Construction Materials Co., Construction Division, Tucson, Arizona, with a remittance slip attached (Plaintiff Apache's exhibit 11-A in evidence) stating: "Billed to Pioneer Const., Inv. 42088, 42175, 42256." These are the three invoices for material ordered for, billed and shipped to, and receipted for in the name of, Pioneer Constructors during the month of November, 1956 (Plaintiff Apache's exhibits 3 and 4 in evidence), before Paul A. Swagerty's phone call on December 4, 1956. This payment was credited by Apache Powder Company on the Pioneer Constructors' account (R 221).

Apache Powder Company considered the receipt of the check from Construction Materials Company in payment of Pioneer Constructors' invoices, and decided it was all right to accept the check and apply it on the Pioneer Constructors' account (R 214). The only statements it had received regarding Construction Materials Company were that future orders were to be billed to Construction Materials Company, Construction Division, and that it was a division of Pioneer Constructors, and the only account Apache Powder Company had on the Ajo job was with Pioneer Constructors (R 214, 215). Continued periodic visits by the field engineers to the work at Ajo resulted in reports that there were no unusual circumstances in connection with the work, the work was progressing without any interruption in the schedule, without any change in management, personnel, or equipment (R 215).

On February 13, 1957, Apache Powder Company received a check dated February 12, 1957, for \$3,417.74 from Construction Materials Co., Construction Division, Tucson, Arizona with a remittance slip attached (Plaintiff Apache's exhibit 11-B in evidence) stating: "covers the following Invoices 42291, 42308, 42406, Billed to pioneer." These are the three invoices for ma-

terial billed and shipped to, and receipted for in the name of Pioneer Constructors during the month of December, 1956 (Plaintiff Apache's exhibits 3 and 4 in evidence). This payment was credited by Apache Powder Company on the Pioneer Constructors' account (R 221).

Thereafter another inspection of the work at Ajo again disclosed that the work was progressing under the same management, and with substantially the same personnel and equipment, but that the work was nearing completion (R 202), and near the end of taking explosives in the early part of March, 1957 (R 202).

After the last material was furnished on March 12, 1957, Apache Powder Company learned from credit and press reports of litigation against Pioneer Constructors, and requested its attorneys to investigate (R 202).

An attorney for Apache Powder Company phoned Daniel Mardian of Mardian Construction Company at its Phoenix, Arizona, office on March 19, 1957, and later phoned Harold Ashton of Ashton Building Company at its Tucson, Arizona, office, and on March 19, 1957, Daniel Mardian wrote to Harold Ashton of the phone call from the attorney (Plaintiff Apache's exhibit 1 in evidence) (R 136, 137). Harold Ashton testified, on cross examination by Mr. Carr, in regard to the phone call to him (R 136):

Q. Now, Mr. Ashton, do you recall a telephone conversation with me acting at attorney for Apache Powder Company on March 19, 1957?

A. I recall a telephone conversation with you but I don't recall the date.

Q. Do you recall that I told you that the Pioneer owed Apache money for the job at Ajo and we discussed the matter and told you that I had called Mr. Mardian and Mr. Mardian had suggested my talking with you?

A. I believe I recall that.

Q. Do you recall that after discussing the matter with me

you requested that I talk to Mr. Catlin, the Ashton-Mardian attorney?

A. I believe that's right.

Q. Would you say, Mr. Ashton, that the telephone conversation wasn't held on March 19, 1957?

A. I would not say it wasn't, no.

Q. In that conversation do you recall whether or not I told you that Pioneer Constructors owed Apache Powder Company \$25,312.60 for explosives and blasting supplies delivered at Ajo and used at Ajo and that was the balance due at the time?

A. I don't remember specifically the amount. I remember it was in the \$20,000 figure.

The letter from Daniel Mardian to Harold Ashton sets forth the statement made by the attorney for Apache Powder Company of the claim by Apache Powder Company against Pioneer Constructors for material furnished to Pioneer Constructors and used on the Ajo job in the amount of the balance then due, and copies of the letter were sent (R 138) to the attorney for Ashton-Mardian Company and to Hartford Accident & Indemnity Company.

On March 19, 1957, from its attorney who had called Daniel Mardian on that date, Apache Powder Company first learned of the termination of the Pioneer Constructors subcontract and the execution of the Construction Materials Company subcontract (R 200, 201).

The last of the material Apache Powder Company had delivered on the Ajo job, prior to January 8, 1957, when the Pioneer Constructors subcontract was terminated, was on December 20, 1956 (R 196), and the oral notice to the prime contractor was given within ninety days thereafter on March 19, 1957.

Thereafter, on April 11, 1957, Apache Powder Company received a check dated April 10, 1957, for \$4,411.91, from Construction Materials Co., Construction Division, Tucson, Arizona, with a remittance slip attached (Plaintiff Apache's exhibit 11-C in evidence) stating: "Payment of the Following Invoices #42606

294.88, #42628 280.60, #42646 785.91, #42795 392.70, #42847 1286.22, #43050 1371.90." These are the six invoices for the material billed and shipped to, and receipted for in the name of Pioneer Constructors, during the months of January, February, and March, 1957 (Plaintiff Apache's exhibits 3 and 4 in evidence). This payment was credited by Apache Powder Company on the Pioneer Constructors' account (R 221), leaving a balance of \$20,900.69.

On April 25, 1957, and within ninety days from the date on which it furnished the last of the material on the Ajo job on March 12, 1957, Apache Powder Company, through its attorneys, Evans, Kitchel & Jencks by William A. Evans, mailed three copies of a written notice (Plaintiff Apache's exhibit 6 in evidence), see Appendix 59, of its claim against Pioneer Constructors, addressing one each to Ashton-Mardian Company (Joint Venture), Ashton Building Company, and Mardian Construction Company, mailed by registered mail with return receipts demanded. Apache Powder Company received the registry receipts therefor (Plaintiff Apache's exhibits 7-A, 7-B, and 7-C in evidence).

On August 14, 1957, Apache Powder Company issued a credit memorandum to Pioneer Constructors for a total of \$1,777.73 for explosives and blasting supplies (Plaintiff Apache's exhibit 8 in evidence) (R 206). This was for material returned after the work at Ajo was completed (R 207). On August 28, 1957, Apache Powder Company issued a credit memorandum to Pioneer Constructors for \$175.00 (Plaintiff Apache's exhibit 9 in evidence) for a blasting machine charged to Pioneer Constructors and used on the Ajo job, which also was returned after the work was completed.

These credit memoranda were mailed to Pioneer Constructors, P. O. Box 2768, Tucson, Arizona, and the envelope postmarked August 22, 1957 (Plaintiff Apache's exhibit 10 in evidence), was returned stamped, "Return to writer" and marked "Out of Business" (R 207, 208). They then were mailed to Construction Ma-

materials Company, and were not returned, and Construction Materials Company never made any objection to the credit memoranda being issued to Pioneer Constructors (R 208). These credit memoranda reduced the unpaid balance to \$18,947.96 (R 205).

On June 17, 1957, at the time of the filing of the complaint in the District Court, final settlement of said prime contract with the United States of America had not been made (R 138), and a period of ninety days had elapsed after the day on which the last of the material was furnished by Apache Powder Company on March 12, 1957.

QUESTIONS INVOLVED

The questions involved in this appeal are:

1. Can a supplier's rights under the Miller Act be affected by a change in subcontractors, considering the circumstances surrounding such change and the extent of the supplier's knowledge of said circumstances?
2. In any event, is specific and unquestioned oral notice, given by the supplier to the prime contractor of the supplier's claim against the subcontractor, sufficient notice under the Miller Act if such notice is given within ninety days after delivery of the last of the material to the subcontractor?

SPECIFICATIONS OF ERRORS RELIED UPON

The specifications of errors relied upon by appellant are as follows:

1. The District Court erred in denying Apache Powder Company's motion (R 247), made at the close of its case, for an amendment to the amended complaint to conform to the evidence, alleging that oral notice of Apache Powder Company's claim against Pioneer Constructors and Construction Materials Company was given to the prime contractor, Ashton-Mardian Company on March 19, 1957, by Apache Powder Company within ninety (90) days after the last material was furnished by

Apache Powder Company on the Ajo job on December 20, 1956, for the reasons that such proposed allegation conformed to the evidence, and was material in that such oral notice sufficiently complies with the requirement and intendment of Act of Congress of August 24, 1935, c. 642, § 2, 49 Stat. 794, 40 U.S.C.A. § 270b(a).

2. The District Court erred in finding (R 69) that Apache Powder Company did furnish material to the subcontractor, Pioneer Constructors, from June 13, 1956, to and including the 31st day of October, 1956, at the special instance and request of Pioneer Constructors of a reasonable value of \$20,900.39, without at the same time finding that the last of the material furnished by Apache Powder Company on said Ajo radar station job prior to January 8, 1957, was on December 20, 1956, such additional findings being material and being required by the undisputed evidence on these points.

3. The District Court erred in finding (R 69) that Pioneer Constructors ceased the doing of any work on the Ajo job on October 31, 1956, and Construction Materials Company did perform all work encompassed under Pioneer Constructors' subcontract done on and after November 1, 1956, without at the same time finding that until January 8, 1957, Pioneer Constructors was held responsible and liable under its subcontract and bond to the prime contractor by Ashton-Mardian Company, the prime contractor, and that from and including November 1, 1956, to and including January 8, 1957, the work performed by Construction Materials Company on said job was preformed under the same management, using the same office, employing substantially the same personnel and equipment, and obtaining its material and supplies from the same suppliers as had Pioneer Constructors prior to November 1, 1956, such additional findings being material and being required by the undisputed evidence on these points.

4. The District Court erred in finding (R 70) that, on December 4, 1956, in the expectation that the (termination of)

Pioneer Constructors' subcontract and the entry of Construction Materials Company into a subcontract would soon thereafter be formally accomplished, Construction Materials Company caused Apache Powder Company to be notified that all materials thereafter supplied or delivered by Apache Powder Company to the aforesaid job were to be billed to Construction Materials Company, without at the same time finding that such notification was given by the person who previously had ordered the material for the Ajo job as an employee of Pioneer Constructors, that such person did not notify Apache Powder Company that he then was an employee of Construction Materials Company, and that such person then voluntarily stated that Construction Materials Company was a division of Pioneer Constructors, such additional findings being material and being required by the undisputed evidence on these points.

5. The District Court erred in finding (R 71) that after December 4, 1956, and not later than January 8, 1957, Apache Powder Company had knowledge and information which would have led a reasonably prudent person in the same situation to make an investigation of the subcontract situation on the Ajo job and the relation of Pioneer Constructors and Construction Materials Company thereto, for the reason that Pioneer Constructors' subcontract had not been terminated on December 4, 1956, and was not terminated until January 8, 1957, and Apache Powder Company had no notice or knowledge until March 19, 1957, that Pioneer Constructors' subcontract had been terminated, and such findings are not supported by the evidence and are contrary thereto.

6. The District Court erred in finding (R 72) that Apache Powder Company failed to make any reasonable effort under the circumstances to ascertain the facts regarding the subcontract situation and the relationship of Pioneer Constructors and Construction Materials Company thereto, and that Apache Powder Company did not act with ordinary prudence in protecting its rights as against the prime contractor and its surety, for the rea-

son that such findings are not supported by the evidence and are contrary thereto.

7. The District Court erred in concluding (R 74) that the written notice given by Apache Powder Company to Ashton-Mardian Company on April 25, 1957, did not comply with the requirements of Act of Congress of August 24, 1935, c. 642, § 2, 49 Stat. 794, 40 U.S.C.A. § 270b(a), for the reason that Apache Powder Company could not be charged with notice or knowledge until March 19, 1957, of the termination of Pioneer Constructors' subcontract; written notice was given by Apache Powder Company to the prime contractor within ninety days after Apache Powder Company furnished the last of the material on the Ajo job, March 12, 1957, and the District Court's conclusion is therefore not supported by the law and the evidence and is contrary thereto.

8. The District Court erred in concluding (R 66) that the oral notice given by Apache Powder Company to Ashton-Mardian Company, the prime contractor, on March 19, 1957, given within ninety days from December 20, 1956, on which date Apache Powder Company furnished the last of the materials on the Ajo job prior to January 8, 1957, when Pioneer Constructors' subcontract was terminated, did not comply with the requirements of Act of Congress of August 24, 1935, c. 642, §2, 49 Stat. 794, 40 U.S.C.A. § 270b(a), for the reason that said oral notice did comply with the requirements of said Act of Congress, and said conclusion is not supported by the law and the evidence and is contrary thereto.

9. The District Court erred in concluding (R 74) that Apache Powder Company is not entitled to judgment against the defendants, The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in joint venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, or any of them, under the first count of the amended

complaint, and that said defendants are entitled to judgment against Apache Powder Company for their costs of suit, for the reason that such conclusions are not supported by the law and the evidence and are contrary thereto.

10. The District Court erred in ordering, adjudging, and decreeing (R 77) that the defendants, The Ashton Company, Inc., Contractors and Engineers, formerly Ashton Building Company, and Mardian Construction Company, corporations engaged in joint venture as Ashton-Mardian Company, and The Travelers Indemnity Company, a corporation, have judgment against Apache Powder Company on the first count of the amended complaint, and that Apache Powder Company take nothing by said first count of the amended complaint from said defendants, or any of them, and that said defendants have their costs of suit, for the reason that such judgments are not supported by the law and the evidence and are contrary thereto.

SUMMARY OF ARGUMENTS

1. Apache Powder Company furnished material which was used on the Ajo job in the prosecution of the work specified in the prime contract and in the subcontract, the last of the material was furnished on March 12, 1957, Apache Powder Company served written notice of its claim on the prime contractor on April 25, 1957, within ninety days after it furnished the last of the material, said claim being for the balance of the amount due on said material, and Apache Powder Company is entitled, under the provisions of the Miller Act, to judgment against the prime contractor and its surety on the prime contractor's payment bond.

2. Apache Powder Company had no actual notice or knowledge of the changes in subcontracts and subcontractors until March 19, 1957, and the facts and circumstances relating to the subcontracts, to the performance of the work under the subcontracts, and to the changes of subcontracts and subcontractors, were

such that they did not give Apache Powder Company any reason to believe there were any such changes.

3. Apache Powder Company had no actual notice or knowledge of the changes in subcontracts and subcontractors until March 19, 1957, and the information it received and the information allegedly given to it by Construction Materials Company employees was not sufficient to charge Apache Powder Company with notice or knowledge of such changes.

4. Even if, from the information received by and allegedly given to Apache Powder Company, a duty was imposed upon it to make an investigation, its periodic investigations of the situation at Ajo satisfied the requirements of that duty, and Apache Powder Company's actions under the circumstances were reasonable.

5. The Miller Act should be liberally construed to effectuate its purpose, being a remedial act intended to benefit persons who perform labor or furnish material for contractors on public work, and in the interpretation of the act the intention of the Congress to protect those who furnish materials for public buildings and to insure the payment in full for such material should prevail even against the letter of the act.

6. In any event, Pioneer Constructors' subcontract was terminated on January 8, 1957, and Apache Powder Company had delivered material on the Ajo job on December 20, 1956. The oral notice to Ashton-Mardian Company of Apache Powder Company's claim against Pioneer Constructors and Construction Materials Company made on March 19, 1957, was made within ninety days after the delivery of December 20, 1956, and was sufficient notice under the Miller Act.

ARGUMENTS

I

This argument relates to Question 1 and Specifications of Error 2, 7, 9, and 10.

Apache Powder Company furnished material which was used on the Ajo job in the prosecution of the work specified in the prime contract and in the subcontract, the last of the material was furnished on March 12, 1957, Apache Powder Company served written notice of its claim on the prime contractor on April 25, 1957, within ninety days after it furnished the last of the material, said claim being for the balance of the amount due on said material, and Apache Powder Company is entitled, under the provisions of the Miller Act, to judgment against the prime contractor and its surety on the prime contractor's payment bond.

The Act of Congress of August 24, 1935, c. 642, § 2, 49 Stat. 794, 40 U.S.C.A. § 270b(a), see Appendix 51, provides for suit for the amount due for material, or *the balance of the amount due*, under two situations. The first is where the supplier has direct contractual relationship, express or implied, with the prime contractor. The second is where the supplier has direct contractual relationship with a subcontractor, but none with the prime contractor. In the latter case, it is required that the supplier give notice of his claim against the subcontractor to the prime contractor, within ninety days from the date on which said supplier *furnished the last of the material for which the claim is made*.

Apache Powder Company's claim is for the balance due for material furnished on the Ajo job from June 13, 1956, to March 12, 1957. All the material was covered by factory orders and invoices addressed and mailed to Pioneer Constructors, all the material was shipped to and receipted for in the name of Pioneer Constructors (R 191, 192) (Plaintiff Apache's exhibits 3 and 4 in evidence), and all the material was charged to Pioneer Constructors and the monthly statements mailed to Pioneer Constructors (R 197).

The payments made by Construction Materials Company were made on Pioneer Constructors' account with Apache Powder Company. Apache Powder Company applied these payments, and the credit memoranda issued to Pioneer Constructors, on Pioneer

Constructors' account for all the material furnished on the Ajo job. There always was a balance due on the Pioneer Constructors' account which, prior to the first payment by Construction Materials Company, amounted to \$29,041.50, being the \$20,900.39 for material furnished prior to November 1, 1956, and \$8,141.11 for material furnished during November and December, 1956. This balance thereafter was reduced by the payments made by Construction Materials Company and the credit memoranda issued to Pioneer Constructors (R 206) to the \$18,947.96 for which judgment was sought (R 33, 52).

The application of the payments made by Construction Materials Company, and the credit memoranda issued to Pioneer Constructors, to Pioneer Constructors' account, and the current balances due on the account, were shown on the monthly statements (R 197, 198). Neither Pioneer Constructors nor Construction Materials Company objected to these applications and balances, and neither claimed that the Construction Materials Company payments should be applied to the payment for the materials furnished after November 1, 1956 (R 197, 208).

Thus the written notice of claim was for the balance due for materials for which the claim is made, and the material furnished on March 12, 1957, was the last and part of the material for which claim is made.

The plain and simple language of the act authorizes and requires judgment against the prime contractor and its surety on the prime contractor's payment bond. Any other interpretation would require that the language of the act be altered and that some additional language be read into the act.

II

This argument relates to Question 1 and Specifications of Error 3, 9, and 10.

Apache Powder Company had no actual notice or knowledge of the changes in subcontracts and subcontractors until March 19,

1957, and the facts and circumstances relating to the subcontracts, to the performance of the work under the subcontracts, and to the changes of subcontracts and subcontractors, were such that they did not give Apache Powder Company any reason to believe there were any such changes.

In Section 1 on both of the subcontracts, detailing the parts of the work specified in the prime contract which were to be done by the subcontractor, the work specified to be performed is identical (R 116, 118). See Appendix 53, 56.

The supplement sheets attached to the subcontracts show that the items to be performed are identical, except Item 30 which had been completed by Pioneer Constructors, and the unit prices are identical, the differences shown being in the quantities to be performed or supplied, the extensions of the amounts, and the total (R 128). See Appendix 55, 58.

Pioneer Constructors' subcontract is No. 7 and Construction Materials Company's subcontract is No. 128, but the supplement sheet attached to the Construction Materials Company subcontract is entitled "Supplemental Sheet to Subcontract No. 7" (R 119). See Appendix 58.

The Pioneer Constructors' subcontract is for \$401,217.38 and the Construction Materials Company subcontract is for \$266,391.36, which was estimated as of October 31, 1956, to be the amount of work remaining to be performed (R 120, 131).

By their actions and the conditions imposed, Pioneer Constructors, Construction Materials Company, and Ashton-Mardian Company treated the two subcontracts as one.

When, during the latter part of November, 1956 (R 112), Pioneer Constructors, Construction Materials Company, and Ashton-Mardian Company agreed that Construction Materials Company would take over the subcontract of Pioneer Constructors on the Ajo job as of November 1, 1956 (R 112, 117), J. E. Skorpick and Thomas E. Moore represented both the subcontract-

tors. And Ashton-Mardian Company made two conditions. Construction Materials Company had previously been engaged in the construction materials business, and had done no construction work (R 257), and Ashton-Mardian Company required that the work proceed under the same management, and with same personnel and equipment as under the Pioneer Constructors' subcontract (R 132). The second condition was that Construction Materials Company execute and deliver to Ashton-Mardian Company a new subcontractor's bond, with acceptable surety, preferably the same as the surety on the Pioneer Constructors' bond, for performance and payment under Construction Materials Company's subcontract (R 123).

After the agreement between the three companies, a subcontract (Plaintiff Armco's exhibit 7 in evidence) from Ashton-Mardian Company to Construction Materials Company was prepared, dated November 1, 1956, and signed by Construction Materials Company, but not executed and delivered by Ashton-Mardian Company until January 8, 1957 (R 124, 125) when Construction Materials Company's subcontractor's bond was executed and delivered to Ashton-Mardian Company. The subcontract to Pioneer Constructors was terminated at the same time (R 125).

Furthermore, even before J. E. Skorpick and Thomas E. Moore, representing Construction Materials Company, approached Harold Ashton in the last half of November, 1956, for a new subcontract to Construction Materials Company (R 112), Construction Materials Company, beginning on November 4, 1956, took over the payroll (R 158), and the work specified in the Pioneer Constructors' subcontract which had not then been completed (R 120). And, during the period from November 4, 1956, to January 8, 1957, Ashton-Mardian Company held Pioneer Constructors liable and responsible on its subcontract and bond, and Ashton-Mardian Company made no payments to Construction Materials Company until after the new bond was furnished (R 125, 126).

The United States project engineer was never officially notified that Construction Materials Company was a subcontractor (R 99).

As required by Ashton-Mardian Company (R 132), Construction Materials Company, in completing the work originally specified in the Pioneer Constructors' subcontract, used the same offices as Pioneer Constructors (R 149), operated under the same management, took over the payroll (R 158) and employed substantially the same personnel, and used substantially the same equipment (R 120). There was no interruption in the work schedule (R 199). The name of Pioneer Constructors was on some of the equipment used on the Ajo job, and the name of Construction Materials Company did not appear on any of the equipment until after the first of the year 1957 (R 121, 122).

There was no change in the work to be performed for which Apache Powder Company was furnishing the explosives and blasting supplies, and there was no change in the performance of the work with respect to management, personnel, equipment, suppliers, or work schedule. There was no change-over, either on November 1, 1956, November 4, 1956, or January 8, 1957, which ordinarily would have occurred upon a change of subcontracts and subcontractors, with the old management, personnel, and equipment moving out and the new moving in, and new arrangements with the suppliers, to give Apache Powder Company any reason to believe there were any such changes.

III

This argument relates to Question 1 and Specifications of Error 2, 3, 4, 5, 6, 7, 9, and 10.

Apache Powder Company had no actual notice or knowledge of the changes in subcontracts and subcontractors until March 19, 1957, and the information it received and the information allegedly given to it by Construction Materials Company employees was not sufficient to charge Apache Powder Company with notice or knowledge of such changes.

There is no evidence that Apache Powder Company received or was given any information of any change in the situation until the phone call from Paul A. Swagerty on December 4, 1956.

With respect to that phone conversation, Paul Negley testified that Paul A. Swagerty, who was known as an employee of Pioneer Constructors, gave him an order for material, informed him that the balance of the materials for the Ajo job should be billed to Construction Materials Company, Construction Division, Tucson, Arizona, and that Construction Materials Company, Construction Division, was a division of Pioneer Constructors. Paul Negley made a pencilled notation of the order and these statements by Paul A. Swagerty, and stated that he is positive that Paul A. Swagerty said that Construction Materials Company, Construction Division, was a division of Pioneer Constructors (R 240, 241, 243).

The testimony of Paul A. Swagerty with respect to the telephone conversation of December 4, 1956, in substance is that he told Paul Negley that future billings with regard to the Ajo work should be billed to Construction Materials, Construction Division, and thinks he told him in answer to a question about an address that he could forward the statements to the same place he had previous ones, and that Melvin J. Simmons would take care of them (R 252). Paul A. Swagerty said he did not recall anything being said as to the status of Construction Materials Company, whether it was or was not a division of Pioneer Constructors, and to the best of his knowledge he had not made such a statement to Paul Negley or anyone else, because he didn't know what affiliates the firm had (R 252). However, there is no evidence that Paul A. Swagerty made or referred to any written memorandum of the conversation, and on cross examination said he did not deny that he told Paul Negley that Construction Materials Company, Construction Division, was a division of Pioneer Constructors (R 253, 254). The only time Paul A. Swagerty said anything about billing to Construction Materials Company was in this telephone conversation of December 4, 1956 (R 255), and

the most he told Paul Negley at that time was that shipments to Ajo should be billed to Construction Materials Company, Construction Division (R 259).

Immediately after this telephone conversation of December 4, 1956, with Paul A. Swagerty, Paul Negley reported it to J. L. Schmalzel, his immediate superior (R 238), and it then was reported to R. L. Henderson, the general manager of Apache Powder Company (R 211). The information received was considered, and thereafter Apache Powder Company continued to bill and ship the material to Pioneer Constructors (R 212, 213).

R. L. Henderson gave as the reasons for this action (R 213) that the arrangements for supplying explosives and loaning magazines had been made with Pioneer Constructors, the subcontractor on the job; Apache Powder had no notice that the subcontract with Pioneer Constructors had been terminated; and Apache Powder Company had not been approached by Construction Materials Company, and had no arrangements with it for sale or delivery of explosives or loan of magazines. Furthermore, in view of the information that Construction Materials Company, Construction Division, was a division of Pioneers Constructors, R. L. Henderson thought it natural to assume (R 235) that Apache Powder Company was still doing business with Pioneer Constructors.

Appellant, under the above-mentioned circumstances, contends that Apache Powder Company's action in continuing to bill Pioneer Constructors was consistent with the information it had received, and that it was reasonable and proper for Apache Powder Company to continue to bill the principal or parent company, in the absence of any further information or notice, having made its arrangements with and having its account with the principal or parent company.

Thereafter the investigations in the field disclosed that there had been no change in the management, personnel, equipment, or work schedule on the job at Ajo, and none of the factory orders

and invoices made out to and mailed to Pioneer Constructors was returned for correction. The bills of lading were returned, receipted for in the name of Pioneer Constructors, and no further requests were made for billing to Construction Materials Company, Construction Division. Apache Powder Company assumed, and had a right to assume that it was still furnishing material to Pioneer Constructors under its subcontract.

Next in order of time is the purported call from Melvin J. Simmons on December 10, 1956, to Apache Powder Company. Later, when the testimony by Melvin J. Simmons in his deposition relating to this phone call was reported to Apache Powder Company, an investigation was made, and no one at Apache Powder Company was found who had received it or heard of it (R 218). And R. L. Henderson (R 217), and J. L. Schmalzel and Amos J. Browning, who would have received it if it had been made, each testified that he had received no such call (R 245, 246).

Melvin J. Simmons testified (R 179) that he didn't know whether he called the purchasing department or the accounting department at Apache Powder Company, that he did not ask the name of the person with whom he talked or his capacity with the company, and when first questioned about the call (R 178) said he did not recall the date, but thought it was in the latter part of January or February, 1957, and may have been later than that. When he was reminded that in his deposition he had fixed the date as December 10, 1956, he said that was the date. However, there is testimony by both participants (R 105, 171) of a call on December 10, 1956, between Gerald John Sturm of Armco Drainage & Metal Products Company and Melvin J. Simmons on a very similar subject, and Melvin J. Simmons may have been thinking of that call. Moreover, in connection with that conversation, Gerald John Sturm denied that Melvin J. Simmons had said that Construction Materials Company had taken over the job and at that time was subcontractor on the job and that Pioneer Constructors were no longer on the job.

Whether or not Melvin J. Simmons did call Apache Powder Company on or about December 10, 1956, the most that he claims is that he requested that future orders be billed to Construction Materials Company, because it was doing the work. This would have been consistent with Paul A. Swagerty's statement on December 4, 1956, and would have provided no further information or notice to Apache Powder Company of any change in the subcontracts and subcontractors.

Then, on December 29, 1956, Apache Powder Company received the first check, dated December 27, 1956, from Construction Materials Co., Construction Division, Tucson, Arizona. This check for \$4,723.37 had a remittance slip attached (Plaintiff Apache's exhibit 11-A in evidence) stating "Billed to Pioneer Const., Inv. 42088, 42175, 42245."

Apache Powder Company considered the receipt of this check, and decided it was all right to accept the payment and apply it on the Pioneer Constructors' account (R 214). The invoices listed on the remittance slip were for the material ordered for, billed and shipped to, and receipted for in the name of Pioneer Constructors during the month of November, 1956, before Paul A. Swagerty's phone call on December 4, 1956, requesting that future billings be made to Construction Materials Company, Construction Division. Apache Powder Company had been informed that Construction Materials Company, Construction Division, was a division of Pioneer Constructors, and the only account it had on the Ajo job was with Pioneer Constructors (R 214, 215). Continued periodic investigations at Ajo resulted in reports that there were no unusual circumstances in connection with the work, and the work was progressing without any interruption in the schedule, and without any change in management, personnel, or equipment (R 215). The request it had received on December 4, 1956, regarding billing to Construction Materials, related only to future billings.

The significance of the facts and circumstances surrounding

this first payment is of great importance. It was a payment on the Pioneer Constructors' account, made by a company which Apache Powder Company had been informed was a division of Pioneer Constructors, listing invoices for material which to that time without question had been ordered by Pioneer Constructors, the principal or parent company, and had been billed and shipped to and receipted for in the name of Pioneer Constructors. Apache Powder Company had not then been informed that Construction Materials Company had taken over the work as of November 1, 1956, and could not have known that the payment was for material Construction Materials Company had used after it took over the work. It was a payment of the current items on the statement for the month of November, the last statement previously issued by Apache Powder Company to Pioneer Constructors. If the first payment made by Construction Materials Company had related to invoices for material ordered on and after December 4, 1956, for which billings to Construction Materials Company had been requested, its significance would have been materially different. As it was, the payment merely meant that the division of Pioneer Constructors that had taken over the work on December 4, 1956, was beginning to make payments on the Pioneer Constructors' account, and had made its first payment to cover the current items of the last monthly statement received.

This certainly was no information charging Apache Powder Company with notice or knowledge that Pioneer Constructors' subcontract had been terminated, and that a new subcontract had been given to a new, different, and independent subcontractor who was not responsible or liable for the payment of the Pioneer Constructors' account for material furnished prior to November 1, 1956. On the contrary, it was information that Construction Materials Company was beginning to pay Pioneer Constructors' account, and had begun by making a payment on the old account.

The evidence is undisputed that Apache Powder Company had no actual notice or knowledge, at the time of the occurrences, of Construction Materials Company taking over the work on Novem-

ber, 4, 1956, as an independent subcontractor or otherwise, of the later negotiations in the latter part of November, 1956, by Pioneer Constructors and Construction Materials with Ashton-Mardian Company for a new subcontract to Construction Materials Company, or of the termination of the Pioneer Constructors' subcontract and the execution of the Construction Materials Company's subcontract on January 8, 1957.

Thus, the next information Apache Powder Company received was as a result of the payment of the second check by Construction Materials Co., Construction Division, dated February 10, 1957, and received on February 13, 1957. This check for \$3,417.74 had a remittance slip attached (Plaintiff Apache's exhibit 11-B in evidence) stating: "covers the following Invoices 42291, 42308, 42406, Billerd to pioneer." The three invoices listed are for the material furnished in December, 1956. This payment was credited by Apache Powder Company on the Pioneer Constructors' account (R 221).

The three invoices listed were on orders made on or after December 4, 1956, when Paul A. Swagerty requested a change in the billing, but the material had been billed and shipped to, and receipted for in the name of Pioneer Constructors (Plaintiff Apache's exhibits 3 and 4 in evidence). None of the factory orders and invoices issued on or after December 4, 1956, had been returned for correction, no objection had been made to the continued billing to Pioneer Constructors, and no further requests for a change in billing had been received. This second check was a payment of the current items on the monthly statement for December, 1956, which showed the application of the first payment to the Pioneer Constructors' account, and no objection was made thereto. And inspections of the work at Ajo continued to show that the work was progressing under the same management, and with substantially the same personnel and equipment.

This was the second payment by Construction Materials Co., Construction Division, on the Pioneers Constructors' account, and

the listing of invoices to Pioneer Constructors had no more significance than the listing of the invoices on the remittance slip attached to the first check. In that instance, the invoices were for material which to that time without question had been ordered by Pioneer Constructors, the principal or parent company, and had been billed and shipped to, and receipted for in the name of Pioneer Constructors. In this instance, the invoices were for material ordered by a division of Pioneer Constructors apparently for use under the principal or parent company's subcontract, which had been billed and shipped to, and receipted for in the name of the principal or parent company. It was just another payment by the division on the account of the principal or parent company.

Under these circumstances, this was no information charging Apache Powder Company with notice or knowledge that Pioneer Constructors' subcontract had been terminated, and that a new subcontract had been given to a new, different, and independent subcontractor who was not responsible or liable for the payment of the Pioneer Constructors' account for material furnished prior to November 1, 1956. On the contrary, it was information that this division of the parent or principal company was continuing to pay Pioneer Constructors' account.

Before the third check was received on April 11, 1957, by Apache Powder Company from Construction Materials Co., Construction Division, the last of the material had been furnished on March 12, 1957, and Apache Powder Company on March 19, 1957, had learned of the termination of the Pioneer Constructors' subcontract and the execution of the Construction Materials Company's subcontract, so that the receipt of the third check could have had no significance with respect to charging Apache Powder Company with notice or knowledge of the changes in subcontracts and subcontractors.

Another point, which was brought out in the cross examination of R. L. Henderson as the general manager of Apache Powder Company, is that Pioneer Constructors had made no payments for

the material furnished prior to November 1, 1956 (R 220), and that the payments received were made by Construction Materials Co., Construction Division.

R. L. Henderson said that he was aware of the situation (R 224), and had given consideration to it (R 228). It was not the policy of Apache Powder Company to let accounts run without payments for several months, but it was not unusual with this type of work with contractors (R 228, 229). The company didn't like to go to the prime contractor and embarrass the subcontractor, if it could be avoided. It had men in the field who watched the jobs, and they reported nothing unusual. It relied on the payment bond of the prime contractor in all cases of contract work. (R 229) There is a competitive angle in the industry, and it is customary to go along with the contractors who do not pay regularly. If Apache Powder Company were to be too rigid and inflexible, it would lose a lot of business because its competitors will be liberal and in many cases more liberal (R 231).

Also on cross examination, R. L. Henderson was asked whether it raised any question in his mind and that of the company (R 230) "when you have an account that is six months old without any payment and then out of a clear blue sky you start getting checks from another organization, so far as the checks themselves show, in payment of the (198) last invoices?" R. L. Henderson replied that this was noted, and that it was the reason Apache Powder Company gave consideration to its course. The information from the field in regard to the job, and the experience with Pioneer Constructors, the subcontractor, was reviewed (R 230). The company's experience with Pioneer Constructors had been very good before, at that point Apache Powder Company could well believe it was going to be paid, and in addition it had confidence in the prime contractor, and did not go to the prime contractor.

An attempt was made to show that Apache Powder Company had credited the individual invoices listed by Construction Materials Company on the remittance slips attached to the checks,

because they were checked off on a statement supplied by Apache Powder Company (Defendant Ashton's exhibit A in evidence), but (R 221) there was no evidence as to who had checked off the individual invoices on the statement, and R. L. Henderson testified (R 221) that the money received from Construction Materials Company on its checks for Pioneer Constructors' material was applied against the entire balance of Pioneer Constructors' account.

In the consideration of the question as to whether Apache Powder Company received any information with which it should be charged with notice or knowledge of the change in subcontracts and subcontractors, it is very apparent that the statement from Paul A. Swagerty that Construction Materials Company, Construction Division, was a division of Pioneer Constructors, is the crux of the entire situation.

Appellant's contention that this statement was made, was immediately reported to the officials of Apache Powder Company, and given careful consideration by them, is supported by positive and undisputed evidence.

And appellant's contention that this statement was considered in connection with all the other information received by Apache Powder Company prior to March 19, 1957, also is supported by positive and undisputed evidence.

Apache Powder Company gave careful consideration to all the information it received, all the conditions and occurrences reported to it. It believed and had a right to believe, in view of all the circumstances, that Construction Materials Company, Construction Division, was a division of Pioneer Constructors. All the information Apache Powder Company received was consistent with the information that Construction Materials Company, Construction Division, was a division of Pioneer Constructors. And all of Construction Materials Company's actions known to Apache Powder Company, and all of Apache Powder Company's actions were consistent with that information.

In connection with the information that it was a division of Pioneer Constructors, the very name, Construction Materials Company, Construction Division, indicated that the organization was a division of some larger organization, and all of its actions known to Apache Powder Company indicated that the larger organization was Pioneer Constructors, in whose name it was acting.

Emphasis was given to the fact that Apache Powder Company did not go to the officials of Pioneer Constructors, Construction Materials Company, or Ashton-Mardian Company and inquire as to the subcontract situation, and that if it had Apache Powder Company would have learned of the true subcontract situation. Apache Powder Company considered doing this, and gave good reason for not doing it.

Obviously, if Apache Powder Company had been informed that Pioneer Constructors' subcontract had been terminated, and a new subcontract given to Construction Materials Company as a new, different, and independent subcontractor, it would have taken further action. There is no evidence, however, that Apache Powder had such notice or knowledge prior to March 19, 1957, and the testimony of Apache Powder Company witnesses is positive and undisputed that it did not have such notice or knowledge prior to that time.

The District Court applied the rule that a person is charged with notice or knowledge of a fact if he had knowledge or information which would have led a reasonably prudent person in the same situation to make an investigation to ascertain the facts in regard to the situation. This is a well-recognized general rule, which appellant did not and now does not contend is not applicable. In imposing the duty to inquire, however, the District Court erred in determining what knowledge or information Apache Powder Company had and what duty was imposed upon it.

In 66 C.J.S., *Notice*, § 11b(4) (b), at page 646, the following limitation on the general rule is stated as follows:

" * * * in order to charge a person with notice of a fact which could have been ascertained by inquiry, the circumstances known to him must have been such as ought reasonably to have suggested inquiry and led him to inquire. The rule imputes notice only of those facts that are naturally and reasonably connected with the fact known, and of which the known fact or facts can be said to furnish a clue. * * *

"Where the circumstances relied on as sufficient to charge a party with notice may be equally as well referred to a different matter as to the one with notice of which he is sought to be charged, they will not be deemed to be sufficient."

In *National Shawmut Bank of Boston v. Topas*, C.C.A. Mass., 60 F.2 467, certiorari denied *Topas v. National Shawmut Bank of Boston*, 53 S.Ct. 292, 287 U.S. 668, 77 L.Ed. 576, it is held that knowledge of facts putting creditor on inquiry as to whether preference would result from accepting funds from insolvent debtor is not necessarily sufficient to put him on inquiry as to debtor's wrongful appropriation of funds to pay loan.

The only knowledge or information that Apache Powder Company had was that Construction Materials Company, Construction Division, had taken over the work at Ajo, that it requested that future billings be made to it, that it was a division of Pioneer Constructors, and that it was making payments on Pioneer Constructors' invoices and account. And, as previously pointed out in detail, everything, including the actions and lack of protest by Construction Materials Company, was consistent with this information.

This knowledge or information did not suggest an inquiry as to the subcontract situation at Ajo and the relation of Pioneer Constructors and Construction Materials Company thereto, because there was nothing inconsistent, and no question was raised as to whether or not Construction Materials Company, Construction Division, had taken over the work, or was a division of Pioneer Constructors. If Construction Materials Company had sent back the factory orders, invoices, or monthly statements for correction, had

used its name in receipting for the material, had protested the application of its first payment to the Pioneer Constructors' account, or had called or written and made some complaint, a question would have been raised, but it did not.

The District Court in finding that there was a duty imposed upon Apache Powder Company of investigating the subcontract situation on the Ajo job, must have found that Apache Powder Company was not informed that Construction Materials Company, Construction Division, was a division of Pioneer Constructors, or must have found that Apache Powder Company had knowledge or information that there had been a change in subcontracts and subcontractors. If it did so find, the findings were not supported by the evidence and are contrary thereto.

For the sake of brevity, appellant will not here repeat its Specifications of Error 2, 3, 4, 5, 6, 7, 9, and 10, relating, respectively, to Findings of Fact No. 7 (R 69), No. 10 (R 69), No. 12 (R 70), No. 16 (R 71), No. 17 (R 72), Conclusions of Law No. 3 (R 74), No. 5 (R 74), and Order (R 77), but hereby specifically refers to them and incorporates them as a part of this argument, and asks that they be considered in the light of the foregoing statements of fact and arguments.

As shown by these findings, conclusions, orders, and judgment, it is apparent that the District Court failed to consider all the facts and circumstances, or failed to consider them in their proper relation to each other, and particularly failed to consider the progressive development of the situation step by step, relating each item of information to the situation then existing, and relating successive items of information and the situation then existing to the previous ones.

Thus, the knowledge or information relied on as sufficient to charge Apache Powder Company with notice of the changes in subcontracts and subcontractors was not sufficient in fact or in law.

IV

This argument relates to Question 1 and Specifications of Error 2, 3, 4, 5, 6, 7, 9, and 10.

Even if, from the information received by and allegedly given to Apache Powder Company, a duty was imposed upon it to make an investigation, its periodic investigations of the situation at Ajo satisfied the requirements of that duty, and Apache Powder Company's actions under the circumstances were reasonable.

As pointed out in Argument III, the only knowledge or information that Apache Powder Company had was that Construction Materials Company, Construction Division, had taken over the work at Ajo, that it had requested that future billings be made to it, that it was a division of Pioneer Constructors, and that it was making payments on Pioneer Constructors' invoices and account.

If any duty was imposed upon Apache Powder Company to make an investigation, it related only to the questions as to whether Construction Materials Company, Construction Division, had taken over the work at Ajo, and whether it was a division of Pioneer Constructors, in order to determine whether this information given to it by Paul A. Swagerty was accurate.

Without repeating the statements and arguments contained in Argument III, but hereby specifically referring to them and incorporating them herein, appellant again contends that the continuing, unchanging situation at Ajo, disclosed by the periodic investigations all through the period in question, wherein there was no change in the management, personnel, equipment, character of work, and extent of work being performed, and no interruptions in the work schedule, was entirely consistent with the statements made by Paul A. Swagerty, and that nothing occurred of an unusual nature which raised any further questions.

In connection with these facts and circumstances, appellant again contends that the actions of Construction Materials Company, in continuing to receipt for the material in the name of Pio-

neer Constructors, in failing to make any objections to the factory orders, invoices, bills of lading, and monthly statements, in making payments on the Pioneer Constructors' account, and in failing to object to the application of those payments, all also are entirely consistent with the statements made by Paul A. Swagerty, and nothing further occurred in connection with these matters of an unusual nature which raised any further questions.

And it should be stressed again, that these investigations, checking bills of lading, and noting failures to object, were active, considered actions by Apache Powder Company in the light of Paul A. Swagerty's statements.

Apache Powder Company contends that, under all the circumstances, it acted in a reasonable and prudent manner, that it did not fail to make a reasonable effort to ascertain the facts, and that it did act with ordinary prudence in protecting its rights. The only thing it did not do, which it is contended it should have done, was go to the officials of the subcontractors and prime contractors. This was considered but was not done because of the competitive situation, because Apache Powder Company did not want to embarrass the subcontractor, if it could be avoided. And, in this connection, it is of the greatest importance to remember that Apache Powder Company was closely watching the progress of the work, the work was not completed, the last of the material was not furnished until March 12, 1957, and *there was no need or purpose until that time to protect its rights against the prime contractor.*

V

This argument relates to all the questions and specifications of error, and to the whole case generally.

The Miller Act should be liberally construed to effectuate its purpose, being a remedial act intended to benefit persons who perform labor or furnish material for contractors on public work, and in the interpretation of the act the intention of the Congress to protect those who furnish materials for public buildings and to

insure the payment in full for such material should prevail even against the letter of the act.

A search of the cases decided under the Miller Act fails to disclose any case similar to this, where there was a change in subcontractors and part of the work is done by one subcontractor and the remainder of the work is done by another.

However, the Supreme Court of the United States has consistently ruled that the act should be liberally construed.

In *Fleisher Engineering & Construction Co. v. U.S. For Use and Benefit of Hallenbeck*, N.Y. 1940, 61 S.Ct. 81, 311 U.S. 15, 85 L.Ed. 12, 14, Mr. Chief Justice Hughes said:

"In construing the earlier Act, the Heard Act, for which the Miller Act is a substitute, we observed that it was intended to be highly remedial and should be construed liberally. United States use of Alexander Bryant Co. v. New York Steam Fitting Co., 235 US 327, 337, 59 L ed 253, 257, 35 S Ct 108; Illinois Surety Co. v. John Davis Co., 244 US 376, 380, 61 L ed 1206, 1211, 37 S Ct 614; Fleischmann Constr. Co. v. United States, 270 US 349, 360, 70 L ed 624, 631, 46 S Ct 284. * * * In short, a requirement which is clearly made a condition precedent to the right to sue must be given effect, but in determining whether a provision is of that character the statute must be liberally construed so as to accomplish its purpose. 'Technical rules otherwise protecting sureties from liability have never been applied in proceedings under this statute.' Illinois Surety Co. v. John Davis Co., 244 US 376, 61 L ed 1206, 37 S Ct 614, supra. The same principle should govern the application of the Miller Act."

And in *Liebman v. U.S. for Use of California Electric Supply Co.*, C.C.A. 9th Cir. 1946, 153 F.2d 350, 352, the Court said:

" * * * The purpose of the Miller Act is to protect those who furnish materials or labor or both for public buildings and to insure the payment in full for such materials and labor. * * * "

In *Hawaii v. Mankichi*, 190 U.S. 197, 213, 23 S.Ct. 787, 47 L.Ed. 1016, 1021, Mr. Justice Brown said:

" * * * But there is another question underlying this and all other rules for the interpretation of statutes, and that is, What

was the intention of the legislative body? Without going back to the famous case of the drawing of blood in the streets of Bologna, the books are full of authority to the effect that the intention of the lawmaking power will prevail, even against the letter of the statute; or, as tersely expressed by Mr. Justice Swayne in *Smith v. Fiske*, 23 Wall. 374, 380, 23 L.ed. 47, 49: 'A thing may be within the letter of a statute and not within its meaning, and within its meaning, though not within its letter. The intention of the lawmaker is the law.' A parallel expression is found in the opinion of Chief Justice Thompson of the supreme court of the state of New York (subsequently Mr. Justice Thompson of this court), in *People v. Utica Ins. Co.*, 15 Johns. 358, 381, 8 Am. Dec. 243: 'A thing which is within the intention of the makers of a statute is as much within the statute as if it were within the letter; and a thing which is within the letter of the statute is not within the statute, unless it be within the intention of the makers.' "

VI

This argument relates to Question 2 and Specifications of Error 1, 8, 9, and 10.

In any event, Pioneer Constructors' subcontract was not terminated until January 8, 1957, and Apache Powder Company had delivered material on the Ajo job on December 20, 1956. The oral notice to Ashton-Mardian Company of Apache Powder Company's claim against Pioneer Constructors and Construction Materials Company made on March 19, 1957, was made within ninety days after the delivery of December 20, 1956, and with the writing evidencing the receipt of the oral notice was sufficient notice under the Miller Act.

Oral notice to Harold Ashton of Ashton Building Company is shown in his testimony (R 136), which is detailed in the Statement of the Case, and oral notice to Daniel Mardian of Mardian Construction Company is shown in his letter to Harold Ashton of March 19, 1957 (Plaintiff Apache's exhibit 1 in evidence).

The contents of these notices satisfy the requirements of § 270b(a) of the Miller Act, which requires the making of a

claim, "stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied".

Plaintiff Apache's exhibit 1 in evidence is written unquestioned evidence of receipt of the oral notice by the prime contractor.

With respect to the provision of § 270b(a) of the Miller Act, which requires that written notice of the claim must be sent by registered mail, the courts, giving a liberal construction to the act, held that the notice need not be sent by registered mail. In *Fleisher Engineering & Construction Co. v. U.S. For Use and Benefit of Hallenbeck*, NY. 1940, 61 S.Ct. 81, 311 U.S. 15, 85, L.Ed. 12, 15, Mr. Chief Justice Hughes said:

" * * * Then the statute goes on to provide for the mode of service of the notice. 'Such notice shall be served by mailing the same by registered mail, postage prepaid,' or 'in any manner' in which the United States marshal 'is authorized by law to serve summons.' We think that the purpose of this provision as to manner of service was to assure receipt of the notice, not to make the described method mandatory so as to deny right of suit when the required notice within the specified time had actually been given and received. *In the face of such receipt, the reason for a particular mode of service fails. It is not reasonable to suppose that Congress intended to insist upon an idle form. Rather, we think that Congress intended to provide a method which would afford sufficient proof of service when receipt of the required written notice was not shown.*" (Underscoring added.)

In *Coffee et al. v. United States, for Use and Benefit of Gordon*, C.C.A. 5th Cir. 1946, 157 F.2d 968, 969, where no written notice was mailed to the prime contractor, but the materialman exhibited to the prime contractor as notice of his claim a writing showing the amount claimed and the identity of the subcontractor, the Court said:

" * * * The Miller Act requires the notice by persons having no direct contractual relationship with the contractor, so that by delaying final settlement with his subcontractors for 90 days after completion of the work he may protect himself and his

bond against such unknown claims. *Written notice is required to prevent misunderstanding and to afford certain evidence of the communication.* The provisions of service afford means of making certain the fact of notice given, or of making a good service where the contractor can not be reached personally. (Underscoring added.)

“(1-3) All the cases agree that without giving the notice there is no right of action on the bond for the use of furnishers who have no direct contractual relation to the contractor. In no case has the writing been held unnecessary. But there has been liberality as to the manner of communicating the written notice to the contractor. We have held in *Birmingham Slag Co. v. Perry*, 5 Cir., 115 F.2d 724, that a letter from one who furnished materials to a subcontractor sent to the owner of the work, a copy of which was timely sent by the owner to the contractor by ordinary mail, was a good written notice. In *Fleisher E. & C. Co. v. United States*, 311 U.S. 15, 61 S.Ct. 81, 85 L.Ed 12, stress was laid on the remedial character of the Miller Act and its predecessor, and while written notice was apparently deemed necessary as a condition precedent to suit, nevertheless the fact that it was addressed to the project engineer and not served by any of the means mentioned in the statute was held immaterial since it in fact reached one of the two contractors. In *Glassell-Taylor Co. v. Magnolia Petroleum Co.*, 5 Cir., 153 F.2d 527, we again emphasized the liberal construction due to be given the Miller Act to effectuate the Congressional intent to protect those who furnish labor and material for public works. In the case now before us we hold that a writing containing the information which the statute requires, exhibited to the contractor by a claimant as a notice of his claim and which the contractor examines and discusses and might have taken if he desired, is a written notice sufficiently served. * * *

The Honorable James A. Walsh, Judge of the District Court, who tried this case, in denying the motion to amend relating to oral notice, cited the case of *Bowden v. United States For the Use of Malloy*, C.C.A. 9th Cir., 1956, 239 F.2d 572, 577, the opinion of which he wrote (R 248). In this opinion, Judge Walsh said:

“We think the teaching of the cases which have dealt most soundly with questions regarding the sufficiency of the notice when it is required to be given by Section 270b(a) may be fairly

summarized as follows: The giving of the written notice specified by the statute is a condition precedent to the right of a supplier to sue on the payment bond; the writing must be sent or presented to the prime contractor by or on the authority of the supplier; and the writing must inform the prime contractor, expressly or by implication, that the supplier is looking to the contractor for payment of the subcontractor's bill."

However, this case dealt with an entirely different fact situation. There was no notice, oral or written, from the supplier to the prime contractor; the writing referred to having been sent by the subcontractor to the prime contractor. And nothing in the letter informed the prime contractor that the supplier expected the prime contractor to pay his bill. There was no written unquestioned evidence of the receipt of an oral notice by the prime contractor. And, in support of the above-quoted statement, Judge Walsh cites *Coffee et al. v. United States, for Use and Benefit of Gordon*, supra, which clearly supports appellant's position.

In *Houston Fire & Cas. Ins. Co. v. U.S. For the Use of Trane Company*, C.C.A. 5th Cir. 1954, 217 F.2d 727, 729, where there was an oral notice from the supplier to the prime contractor and a written acknowledgement by the prime contractor of the receipt of the notice, Chief Judge Hutcheson said:

"The appellee, on its part, citing the many cases in which the courts, construing the statute liberally to effect its purpose of protecting materialmen, have held that the statute is sufficiently complied with if the proof shows convincingly that knowledge is brought home to the principal contractor, urges upon us that, under the undisputed evidence, every essential requirement of the statute was met and fully complied with. Conceding that the statute was not literally complied with because plaintiff did not send a written notice by registered mail, indeed it did not send a written notice of any kind, it yet insists: that what occurred in connection with noticing the claim, plaintiff's oral notice to the principal contractor and a written acknowledgement of the request, and full recognition of Denton's indebtedness to Trane, and the fact that it had not been, but must be, paid was more effective than if a written notice had been sent by the materialmen and fully complied with the essential statu-

tory requirements of bringing home in writing to the principal contractor the requisite knowledge of the claim and debt.

"(1-2) We agree with appellee that this is so. It is true that the statute is carefully and meticulously phrased, and if this were a matter of first impressions, we might find difficulty in coming at once to the conclusion that what was done in this case was a sufficient compliance with it. However, the decisions under the statute, and particularly *Coffee v. United States, for Use and Benefit of Gordon*, supra, Note 4, have made it clear that it was. *It is not necessary that the writing relied on be signed by the supplier, it is sufficient that there exists a writing from which, in connection with oral testimony, it plainly appears that the nature and state of the indebtedness was brought home to the general contractor. When this appears the object of the statute, to assure that the contractor will have notice, is attained and the statute is sufficiently complied with.*" (Underscoring supplied.)

The oral notice to the prime contractor and the written unquestioned evidence of the receipt of the oral notice by the prime contractor satisfy the requirements of the statute. The object of the notice is to assure that the prime contractor will have knowledge of the supplier's claim. The evidence is undisputed that as a result of the phone call on March 19, 1957, Ashton-Mardian Company had that knowledge. The purpose of a written notice is to afford certain evidence of the communication. This is afforded by the letter from Daniel Mardian to Harold Ashton. It is not necessary that the writing be signed by the supplier; it is sufficient if there exists a writing from which, in connection with the oral testimony, it plainly appears that the amount of the claim and the name of the person to whom the material was furnished is brought home to the prime contractor by the supplier.

Thus, every essential of the requirement of the statute has been met, and the District Court erred in denying the motion to amend to conform to the evidence, in concluding that the notice did not comply with the statute and Apache Powder Company is not entitled to judgment, and in ordering judgment in favor of the prime contractor and its surety.

CONCLUSION

Appellant respectfully submits that under the foregoing arguments three separate and different cases have been presented, under each of which appellant is entitled to judgment.

In Argument I it is shown that Apache Powder Company furnished material used on the Ajo job, that it served written notice on the prime contractor within ninety days after the last of the material was furnished, that its claim is for the balance of the amount due on said material, and that the plain and simple language of the Miller Act, under these circumstances shown by undisputed evidence, authorizes and requires judgment in its favor on the prime contractor's payment bond.

In Arguments II, III, IV, and V, again by undisputed evidence, it is shown that Apache Powder Company was not chargeable with notice or knowledge of the change in subcontracts and subcontractors, and acted as a reasonable and prudent person after carefully considering all the information it received, and under the provisions of the Miller Act should not be denied its right to recover the amount of its claim because of the change in subcontracts and subcontractors.

In Argument VI it is shown that, in any event, Apache Powder Company's oral notice of its claim made on March 19, 1957, and the written evidence of the receipt of this notice by the prime contractor, complied with the notice requirements of the statute.

Judgment for the prime contractor and its surety should be reversed, and the District Court should be ordered to enter judgment against them in favor of appellant.

Respectfully submitted,

EVANS, KITCHEL & JENCKES

By ALFRED B. CARR

RALPH J. LESTER

Attorneys for Appellant

APPENDIX

Act of Congress of August 24, 1935, c. 642, §§ 1, 2, 49 Stat. 793, 794, 40 U.S.C.A. §§ 270 a, 270b

§ 270a. Bonds of contractors for public buildings or works; waiver of bonds covering contract performed in foreign country

(a) Before any contract, exceeding \$2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor":

(1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.

(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than \$1,000,000 the said payment bond shall be in a sum of one-half the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than \$1,000,000 and not more than \$5,000,000, the said payment bond shall be in a sum of 40 per centum of the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than \$5,000,000 the said payment bond shall be in the sum of \$2,500,000.

(b) The contracting officer in respect of any contract is authorized to waive the requirement of a performance bond and payment bond for so much of the work under such contract as is to be performed in a foreign country if he finds that it is impracticable for the contractor to furnish such bonds.

(c) Nothing in this section shall be construed to limit the authority of any contracting officer to require a performance bond or other security in addition to those, or in cases other than

the cases specified in subsection (a) of this section. Aug. 24, 1935, c. 642, § 1, 49 Stat. 793.

§270b. Same; rights or persons furnishing labor or material

(a) Every person who has furnished labor or material in the prosecution of the work provided for in such contract, in respect of which a payment bond is furnished under section 270a of this title and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereof, unpaid at the time of institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him: *Provided, however,* That any person having direct contractual relationship with a subcontractor but no contractual relationship express or implied with the contractor furnishing said payment bond shall have a right of action upon the said payment bond upon giving written notice to said contractor within ninety days from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed. Such notice shall be served by mailing the same by registered mail, postage prepaid, in an envelope addressed to the contractor at any place he maintains an office or conducts his business, or his residence, or in any manner in which the United States marshal of the district in which the public improvement is situated is authorized by law to serve summons.

(b) Every suit instituted under this section shall be brought in the name of the United States for the use of the person suing, in the United States District Court for any district in which the contract was to be performed and executed and not elsewhere, irrespective of the amount in controversy in such suit, but no such suit shall be commenced after the expiration of one year after the date of final settlement of such contract. The United States shall not be liable for the payment of any costs or expenses of any such suit. Aug. 24, 1935, c. 642, § 2, 49 Stat. 794.

Front page and supplemental sheet of Sub-contract Agreement No. 7, dated March 30, 1956, from Ashton-Mardian Company to Pioneer Constructors (Plaintiff Armco's exhibit 6 in evidence)

SUB-CONTRACT AGREEMENT

No. 7

ASHTON-MARDIAN COMPANY
(Joint Venture)

Post Office Box 277
Ajo, Arizona

THIS AGREEMENT made this 30th day of March, 1956, by and between ASHTON-MARDIAN COMPANY, hereinafter called the Contractor, and PIONEER CONSTRUCTORS, hereinafter called the Sub-Contractor,

WITNESSETH:

That the Contractor and the Sub-Contractor for the consideration hereinafter named, agree as follows:

Section 1. The Sub-Contractor agrees to furnish all labor, material, equipment and tools to perform all work as described below, in accordance with the general conditions of the Contract (which is available for inspection at all times at the office of the Contractor) by the Owner and the Contractor and in accordance with the drawings and specifications prepared by Corps of Engineers, U.S. Army hereinafter called the Architect-Engineer, all of which general conditions, drawings and specifications signed by the parties thereto are identified by the Architect-Engineer and form a part of the Contract between the Contractor and the Owner, dated March 30, 1956, and hereby becomes a part of this Contract for Air Force Station TM-181 at Ajo, Arizona for Corps of Engineers, U.S. Army hereinafter called the Owner:

All work in accordance with Plans and Specifications and Addenda Nos 1, 2 and 3 and as defined in Specification Part 4, entitled "TECHNICAL PROVISIONS", under

Section 2, CLEARING AND GRUBBING

Section 3, EXCAVATION, EMBANKMENT and
PREPARATION OF SUBGRADE

- Section 4, PIPE CULVERTS,
- Section 6, STABILIZED AGGREGATE BASE COURSE
- Section 7, BITUMINOUS PRIME COAT
- Section 8, BITUMINOUS ROAD MIX SURFACE
COURSE
- Section 9, BITUMINOUS SEAL COAT
- Section 10, GUARD RAIL, GUIDE POSTS, TRAFFIC
SIGNS, DEPTH GAUGES, WHEEL
BUMPERS, TRAFFIC PAINTING, and
CATTLE GUARDS.
- EXCLUSIONS: DEPTH GAUGES,
WHEEL BUMPERS,
TRAFFIC PAINTING
AND CATTLE
GUARDS.

PAYMENT AS PER ATTACHED SHEET.

DO-C2-Certified under DMS Regulation #2.

Section 2. The Sub-Contractor agrees to perform the work progressively as directed by the Contractor and complete the entire project in accordance with Specifications and as directed by Contractor.

Section 3. The Contractor agrees to pay the Sub-Contractor for the performance of his work the sum of \$401,217.83. Payment will be made monthly on approved pay requests, submitted by the end of the month for which payment is requested, for 90 per cent of all work completed to date (as defined in the General Contract). Each payment, including final payment which shall not become due until all of the work has been completed to the full satisfaction of the Architect-Engineer or Owner, will be made to the Sub-Contractor within 5 days after receipt of related payment by the Contractor from the Owner.

Section 4. The Contractor and Sub-Contractor agree to be bound by the terms of the Agreement, general conditions, drawings, and specifications as far as applicable to this Sub-Contract and also by the terms and conditions as set forth on the reverse side entitled "Terms and Conditions," which are specifically incorporated herein and made a part hereof.

The Contractor and Sub-Contractor for themselves and their successors, executors, administrators and assigns, hereby agree to the full performance of the covenants of this Agreement.

IN WITNESS WHEREOF, they have executed this Agreement the date above written.

PIONEER CONSTRUCTORS

Sub-Contractor

J. E. SKORPICK
President

ASHTON-MARDIAN
COMPANY

HAROLD ASHTON

March 30, 1956

SUPPLEMENTAL SHEET TO SUBCONTRACT NO. 7.
PIONEER CONSTRUCTORS.

AIR FORCE STATION, TM-181

Bid

Item

24	Excavation	102,755 cy @	\$ 1.84	\$189,069.20
25	Borrow	10,000 cy	1.70	17,000.00
26	Grader Ditch	6,906 L'	.12	828.72
27	15" CMP	76 L'	6.50	494.00
28	24" CMP	2,444 L'	8.75	21,385.00
29	36" CMP	570 L'	14.00	7,980.00
30	48" CMP	180 L'	21.00	3,780.00
31	Metal End Section for 24" Pipe	4 ea	65.00	260.00
32	Metal End Section for 36" Pipe	4 ea	135.00	540.00
39	Stab. Aggregate Base Course	15,285 cy	3.79	57,930.15
40	Prime Coat	155 ton	46.00	7,130.00
41	Bit. Road-Mix Surface Course	95,246 sy	.31	29,526.26
42	Cutback Asphalt for Bituminous road-mix Surface Course	820 ton	49.00	40,180.00
43	Emulsified Asphalt for Seal Coat	80 ton	46.00	3,680.00
44	Cover Aggregate for Seal Coat	716 ton	6.50	4,654.00
45	Metal Guard Rail	2,290 L	5.25	12,022.50
47	Guide Posts	458 ea	7.50	3,435.00
48	Traffic Signs	54 ea	24.50	1,323.00
				<hr/> \$401,217.83

QUANTITIES SHOWN ARE APPROXIMATE ONLY AND ARE SUBJECT TO DETERMINATION BY THE CORPS OF ENGINEERS AT COMPLETION OF PROJECT.

PIONEER CONSTRUC-
TORS

ASHTON-MARDIAN
COMPANY

By /s/ J. E. SKORPICK
Pres.

By /s/ HAROLD ASHTON

Front page and supplemental sheet of Sub-contract Agreement No. 128, dated November 1, 1956, from Ashton-Mardian Company to Construction Materials Company (Plaintiff Armco's exhibit 7 in evidence)

SUB-CONTRACT AGREEMENT

No. 128

ASHTON-MARDIAN COMPANY
(Joint Venture)

Post Office Box 277
Ajo, Arizona

THIS AGREEMENT made this 1st day of November, 1956, by and between ASHTON-MARDIAN COMPANY, hereinafter called the Contractor, and CONSTRUCTION MATERIALS COMPANY, hereinafter called the Sub-Contractor,

WITNESSETH:

That the Contractor and the Sub-Contractor for the consideration hereinafter named, agree as follows:

Section 1. The Sub-Contractor agrees to furnish all labor, material, equipment and tools to perform all work as described below, in accordance with the general conditions of the Contract (which is available for inspection at all times at the office of the Contractor) by the Owner and the Contractor and in accordance with the drawings and specifications prepared by Corps of Engineers, U.S. Army hereinafter called the Architect-Engineer, all of which general conditions, drawings and specifications signed by the parties thereto are identified by the Architect-Engineer and form a part of the Contract between the Contractor and the Owner, dated November 1, 1956, and hereby becomes a part of this Contract for Air Force Station

TM-181 at Ajo, Arizona for Corps of Engineers, U. S. Army hereinafter called the Owner:

All work in accordance with Plans and Specifications and Addenda Nos. 1, 2 and 3 and as defined in Specification Part 4, entitled "TECHNICAL PROVISIONS", under

- Section 2 CLEARING AND GRUBBING
- Section 3 EXCAVATION, EMBANKMENT and
PREPARATION OF SUBGRADE
- Section 4 PIPE CULVERTS
- Section 6 STABILIZED AGGREGATE BASE
COURSE
- Section 7 BITUMINOUS PRIME COAT
- Section 8 BITUMINOUS ROAD MIX SURFACE
COURSE
- Section 9 BITUMINOUS SEAL COAT
- Section 10 GUARD RAIL, GUIDE POSTS, TRAFFIC
SIGNS, DEPTH GAUGES, WHEEL
BUMPERS, TRAFFIC PAINTING and
CATTLE GUARDS.
EXCLUSIONS: DEPTH GAUGES,
WHEEL BUMPERS,
TRAFFIC PAINTING
AND CATTLE
GUARDS.

PAYMENT AS PER ATTACHED SHEET. DO-C2-Certified under DMS Regulation #2.

Section 2. The Sub-Contractor agrees to perform the work progressively as directed by the Contractor and complete the entire project by in accordance with specifications and as directed by Contractor.

Section 3. The Contractor agrees to pay the Sub-Contractor for the performance of his work the sum of \$266,391.66. Payment will be made monthly on approved pay requests, submitted by the end of the month for which payment is requested, for 90 per cent of all work completed to date (as defined in the General Contract). Each payment, including final payment which shall not become due until all of the work has been completed to the full satisfaction of the Architect-Engineer or Owner, will be made to the Sub-Contractor within 5

days after receipt of related payment by the Contractor from the Owner.

Section 4. The Contractor and Sub-Contractor agree to be bound by the terms of the Agreement, general conditions, drawings, and specifications as far as applicable to this Sub-Contract and also by the terms and conditions as set forth on the reverse side entitled "Terms and Conditions," which are specifically incorporated herein and made a part hereof.

The Contractor and Sub-Contractor for themselves and their successors, executors, administrators and assigns, hereby agree to the full performance of the covenants of this Agreement.

IN WITNESS WHEREOF, they have executed this Agreement the date above written.

CONSTRUCTION MA-
TERIALS CO.
Sub-Contractor

ASHTON-MARDIAN
COMPANY

By T. E. MOORE
Vice-President

HAROLD ASHTON

November 1, 1956

SUPPLEMENTAL SHEET TO SUBCONTRACT NO. 7

CONSTRUCTION
MATERIALS CO.

AIR FORCE STATION, TM-181

Bid Item

24	Excavation	27,810 c.y.	@ \$ 1.84	51,170.40
25	Borrow	24,000 c.y.	1.70	40,800.00
26	Grader Ditch	5,205 L.F.	.12	624.60
27	15" CMP	76 L.F.	6.50	494.00
28	24" CMP	1,061 L.F.	8.75	9,283.75
29	36" CMP	272 L.F.	14.00	3,808.00
31	Metal End Section for 24" Pipe	3 EA.	65.00	195.00
32	Metal End Section for 36" Pipe	1 EA.	135.00	135.00
39	Stab. Aggregate Base Course		3.79	57,930.15
40	Prime Coat		46.00	7,130.00
41	Bit. Surface Course		.31	29,526.26
42	Cut Back Asphalt		49.00	40,180.00

43	Emulsified Asphalt		
	Seal Coat	46.00	3,680.00
44	Cover Agg. for		
	Seal Coat	6.50	4,654.00
45	Metal Guard Rail	5.25	12,022.50
47	Guide Posts	7.50	3,435.00
48	Traffic Signs	24.50	1,323.00
			<u>\$266,391.66</u>

QUANTITIES SHOWN ARE APPROXIMATE ONLY
AND ARE SUBJECT TO DETERMINATION BY THE
CORPS OF ENGINEERS AT COMPLETION OF PROJECT.

CONSTRUCTION	ASHTON-MARDIAN
MATERIALS COMPANY	COMPANY
By /s/ T. E. MOORE	By /s/ HAROLD ASHTON
Title	Title

Notice of claim against Pioneer Constructors made by Apache Powder Company, dated April 25, 1957, addressed to Ashton-Mardian Company (Joint Venture), Ashton Building Company, and Mardian Construction Company, and mailed by Registered Mail (Plaintiff Apache's exhibit 6 in evidence)

EVANS, KITCHEL & JENCKES
8th Floor Title & Trust Building
Phoenix, Arizona
April 25, 1957

REGISTERED MAIL

Ashton-Mardian Company (Joint Venture)
P. O. Box 7065
Tucson, Arizona

Ashton Building Company
P. O. Box 7065
Tucson, Arizona

Mardian Construction Company
1314 North 21st Avenue
Phoenix, Arizona

Re: Corps of Engineers, U. S. Army
Contract for Air Force Station
TM-181 at Ajo, Arizona

Gentlemen:

Pursuant to subparagraph (a), § 270b, Title 40, United States Code Annotated, you are hereby notified as the contractor in the above-mentioned contract, who furnished the Payment Bond to the United States of America, that from and including June 13, 1956, to and including March 12, 1957, Apache Powder Company of Benson, Arizona, furnished or supplied materials consisting of explosives and blasting supplies to Pioneer Constructors and Construction Materials Company of Tucson, Arizona, for use in the prosecution of the work provided for in said above-mentioned contract, in the amount of Thirty-three Thousand Four Hundred Fifty-three and 71/100ths Dollars (\$33,453.71), of which Twelve Thousand Five Hundred Fifty-three and 02/100ths Dollars (\$12,553.02) has been paid, leaving a balance of Twenty Thousand Nine Hundred and 69/100ths Dollars (\$20,900.69).

The last of said materials was furnished on March 12, 1957, and all of said materials was delivered by Apache Powder Company on the job and was used in the prosecution of the work provided for in said above-mentioned contract.

Yours very truly,

APACHE POWDER COMPANY

By EVANS, KITCHEL & JENCKES

By /s/ William A. Evans

Attorneys for Apache Powder Company

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Ident.**Marked in
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No. 16,052

In the

United States Court of Appeals

For the Ninth Circuit

APACHE POWDER COMPANY, a corporation,
Appellant,
vs.

THE ASHTON COMPANY, INC., CONTRACTORS
AND ENGINEERS, formerly ASHTON BUILD-
ING COMPANY, and MARDIAN CONSTRUC-
TION COMPANY, corporations engaged in
Joint Venture as ASHTON-MARDIAN COM-
PANY; and THE TRAVELERS INDEMNITY
COMPANY, a corporation,
Appellees.

Appellees' Answering Brief

Appeal from the United States District Court for the District of Arizona

HALL, CATLIN & JONES

1010 Valley National Building
Tucson, Arizona

CONNER & JONES

510 Valley National Building
Tucson, Arizona

Attorneys for Appellees

FILED

NOV - 3 1958

PAUL P. O'BRIEN, CLERK

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In the
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APACHE POWDER COMPANY, a corporation,
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Joint Venture as ASHTON-MARDIAN COM-
PANY; and THE TRAVELERS INDEMNITY
COMPANY, a corporation,
Appellees.

Appellees' Answering Brief

Appeal from the United States District Court for the District of Arizona

JURISDICTION

Appellees accept appellant's statement of jurisdiction matters as correct.

STATEMENT OF THE CASE

Appellees respectfully submit that appellant has stated as facts matters which are either contrary to the evidence or upon which the evidence is conflicting and on which the trial court resolved the conflict adverse to appellant's contentions.

The history of the transaction between appellee, Ashton-Mardian Company, and the United States of America and The Travelers Indemnity Company and concerning the contract between Ashton-Mardian Company and Pioneer Constructors is substantially correct. Appellees however submit that the asserted agreement between Pioneer Constructors and Apache Powder Company was nothing more than an order which resulted in materials being furnished on open account.

Appellant's statement as to the facts surrounding the shipments made from June 13, 1956 until the latter part of November is correct.

As to appellant's statement in the last paragraph of page 5 of its brief, that the negotiations between Pioneer Constructors, Construction Materials Company and Ashton-Mardian Company during the latter part of November, 1956, was without notice or knowledge thereof by Apache Powder Company is literally true as of the time specified. However, Apache Powder Company received actual notice of the change, to-wit, that Construction Materials Company was on the job on December 4, 1956 (R 233, R 251, R 252); again on December 10, 1956 (R 165-166); and received constructive notice thereof on December 29th when a check was received signed by Construction Materials Company paying the current invoices only and not the old Pioneer Constructors' invoices (R 233-234). Appellant's statement that Ashton-Mardian Company required that the work proceed under the same management and with the same personnel and equipment as under the Pioneer Constructors' subcontract does not appear to be supported by any evidence. The testimony being that this was not a condition (R 132).

Appellees submit that appellant's statement in the second paragraph on page 6 that Apache Powder Company had no

notice or knowledge of the termination of the Pioneer Constructors' subcontract is not correct but as stated above said company had received actual notice on at least two occasions and constructive notice thereafter.

The subcontractor on the job after November 1, 1956, was at all times Construction Materials Company (R 149).

Appellant quotes at considerable length, on pages 9 to 12 of its brief, from the evidence regarding the telephone conversations on December 4th and December 10th. Some of this evidence is sufficient to establish that appellant was notified on those dates that Construction Materials Company was then on the job, while part of the evidence is to the contrary. There was therefore a conflict of evidence on this point. Appellees contend that the preponderance of the evidence is that such notice was given and such was found as a fact by the trial court.

As appellant analyzes the case, a brief statement of the case is as follows: Appellee, Ashton-Mardian Company, was general contractor on the construction job in question, while appellee, Travelers Indemnity Company, was its surety on the bond required by the Act of Congress known as the Miller Act. On March 30, 1956, the said Ashton-Mardian Company entered into a subcontract with Pioneer Constructors for the performance of certain work involved in said project. We believe that these facts are undisputed.

From June 13, 1956, to and including the 24th day of October, 1956, appellant furnished material to said Pioneer Constructors on open account (R 187-R 294). Thereafter, in November of 1956, it was agreed between appellee, Ashton-Mardian Company, Pioneer Constructors, and Construction Materials Company that Construction Materials Company would take over the uncompleted work as of November 1, 1956 (R 112, R 116-R 131). Construction Materials actually took over the job on November 1, 1956 (R 163).

Appellant continued delivering materials to the job during November and on December 4, 1956, was notified by telephone that future orders on this Ajo work should be billed to Construction Materials Company (R 252) and again on December 10, 1956, was advised that Construction Materials Company was doing the work and that powder should be billed to Construction Materials Company (R 166). The last material delivered by appellant to any customer or subcontractor on the Ajo job was on March 12, 1957.

Pioneer Constructors was and is indebted to appellant in the sum of \$18,947.96, no part of which has been paid. Construction Materials Company paid for all of the powder and other materials furnished by appellant after November 1, 1956, the remittances showing that payment was being made on the invoices for materials furnished after November 1, (R 295) the first of said payments having been made on December 29, 1956.

The last material was delivered by appellant to Pioneer Constructors on October 24, 1956 (R 294). On March 19, 1957, or four months and twenty-six days after the delivery of said material appellant gave its oral notice to appellee of its claim, said notice being three months and fifteen days after December 4, 1956, the date on which appellant was first advised of the change, and three months and nine days after December 10, the date on which it was again advised, and it was not until April 25, 1957, that appellant gave written notice to appellee in a belated attempt to comply with the Miller Act.

QUESTIONS INVOLVED

Appellees submit that the questions involved in this appeal could be better stated as follows :

1. Under the Miller Act, what steps must a supplier of materials used on a government project take to have a cause of action against the prime contractor and its surety when the supplier has furnished supplies to two subcontractors, only one of which has defaulted in payment of its obligations, and when the supplier has no contractual relationship, either express or implied, with the prime contractor?

2. Is specific and unquestioned oral notice given by a supplier to the prime contractor of the supplier's claims against one defaulting subcontractor sufficient notice under the Miller Act provided such notice is given within 90 days after the delivery of the last of the materials to the subcontractor?

3. Was the oral notice in this case given within 90 days after the delivery of the last of the material to the defaulting subcontractor?

ANSWERS TO ARGUMENTS

The appellees will attempt to frame their answer to the appellant's arguments under the same categories and divisions as those chosen by the appellant. In doing this, however, appellees make the following pertinent statements of fact and law which are involved in many of the arguments made by appellant.

1. Appellant, Apache Powder Company, had direct contractual relationship with the subcontractor, Pioneer Constructors, but had no contractual relationship, either express or implied, with the contractor, appellee, Ashton-Mardian Company (R 73-74). This particular fact and conclusion of the lower court is not questioned by appellant.

2. So far as this appeal is concerned, this action is not one against a debtor of Apache Powder Company, appel-

lant, but is against a third party appellee, Ashton-Mardian Company, as prime contractor, under a procedure and right authorized solely by statute. The United States Supreme Court in the case of *United States, ex rel, Texas-Portland Cement Company v. D. C. McCord and National Surety Company of New York*, 233 U.S. 157; 34 S.Ct. 550; 58 L.Ed. 893, in speaking in a case involving the prior statute dealing with the same subject matter as the one involved herein stated:

“The statute thus creates a new liability and gives a special remedy for it, and upon well settled principles the limitations upon such liability become a part of the right conferred, and compliance with them is made essential to the assertion and benefit of the liability itself.”

In the case of *United States to Use of Yarnell v. Southern Drafting Company, et al*, 251 F. 400 at 402, also dealing with the prior statute to the one involved herein, it is stated:

“Where a new right is created by statute, unknown to the common law, and the mode in which it may be enforced is specifically provided, the prescribed mode measures the extent of the power, and the right can be enforced in no other manner.”

See also *United States for the Use and Benefit of John Denie's Sons Co. v. Bass, et al*, C.C.A. 6th Cir., 1940, F.2d 965; *National Surety Corp. v. Wunderlich*, C.C.A. 6th Cir., 1940, 111 F.2d 622. See also the case of *Bowden, et al. v. United States of America for the Use of Malloy*, C.C.A. 9th Cir., 1956, 239 F.2d 572, in which it is stated:

“It cannot be doubted that one purpose of Congress in enacting the Miller Act was the protection of laborers and materialmen. But it is clear too, we think, from the mechanics provided in the Act for its operation and the

accomplishment of its purpose, that it was the intent of Congress to fix a time limit after which the prime contractor could make payment to the subcontractor with certainty that he would not thereafter be faced by claims of those who had supplied labor and materials to the subcontractor."

3. At no place in the Miller Act (40 U.S.C.A. 270b(a)) is any notice provided or required from the prime contractor to suppliers of his subcontractors even as to completion date of the project.

4. That from and after November 4, 1956, Construction Materials Company did in fact perform all labor on the Ajo job for which supplies from appellant were furnished and Pioneer Constructors did in fact cease to do any work on the job after October 31, 1956 (R 163-R 256).

5. That all materials furnished or supplied by appellant on the Ajo job after November 1, 1956 were paid for by Construction Materials Company prior to the notice from appellant to appellees dated April 25, 1957 (R 73-R 295).

6. All sales made by appellant to either Pioneer Constructors or Construction Materials Company for supplies used on the job in question were on an open account basis and not made pursuant to formal contract or exclusive agreement (R 218-219).

7. At no time prior to March 19, 1957, did the appellant, Apache Powder Company, have any direct detailed knowledge of any written contract existing between the appellees and either Pioneer Constructors or Construction Materials Company (R 218-219).

8. The lower court did *not* find that appellant, Apache Powder Company, was informed by a representative and employee of Construction Materials Company, Paul A. Swagerty, that Construction Materials Company, Construc-

tion Division, was a division of Pioneer Constructors (R 70-R 253).

For purposes of clarity, appellees set forth in its entirety the cross-examination of witness, Paul A. Swagerty, by Mr. Lester, attorney for appellant (R 253-254):

“Q. (By Mr. Lester): You have just told us that you didn’t know what the exact relationship was between the two companies at that time?

A. No. I had no way of knowing.

Q. It is entirely possible, isn’t it, that you may have said something about the relationship, which you thought may have been the relationship between the two companies at that time?

A. As I remember it, since the mail and everything was handled through the same office, I think I made mention to him that the bills should be submitted to the same channels. What he made out of that, I don’t know, but as far as what I—the contract I had with Tucson 130 miles away, our payrolls et cetera went through the same channels.

Q. But the point is you did not then know what the situation was between the two companies, isn’t that true?

A. I know that I drew my check or was drawing my check from Construction Materials, Construction Division.

Q. Isn’t it true at that time you did not know exactly the relationship between those two companies? [226]

A. No, I don’t—I don’t think I know anything of the Company policy even to this date.

Q. That would be more true then than today, isn’t that correct?

A. The only thing I know about the people are the ones that hire me and the ones I work for.

Q. Isn’t that true that you knew less about the relationship between those two companies than you do now?

A. I don't know anything of the relationship now.

Q. It is entirely possible you may have said something that caused Mr. Negley to jot down the notation he did about your conversation?

A. I am not denying. He could have.

From looking at the entire examination, it is quite obvious that question No. 2 and the answer thereto is to all intents and purposes the same as question No. 7 and the answer thereto. Taken alone, as quoted in the statement of facts submitted by the appellant, Mr. Swagerty's answer to question No. 7 would appear to be something other than it was.

The only testimony that such a statement was made is that of witness for the appellant, Paul Negley, and a portion of plaintiff Apache Powder Company's Exhibit No. 3, being a pencilled memorandum made by the witness, Paul Negley (R 280). There being a conflict in evidence as to this point the court having heard the case, sitting without a jury, it is the sole trier of this fact.

ANSWER TO ARGUMENT I

An analysis of appellant's Argument I would appear to be that regardless of how many subcontractors a supplier supplied materials to on a given government project, that the required 90 day notice would be determined from the last of the materials furnished to all or any of the subcontractors and not from that furnished the particular subcontractor who remained indebted to the supplier. Thus, if a supplier furnished supplies on a given government project to subcontractor A in June, July and August of 1956, and no materials to him thereafter and to subcontractor B in September, October and November of 1956 and no materials thereafter and to subcontractor C in December, 1956, January and February, 1957, and was fully paid by

subcontractors B and C and was not fully paid by subcontractor A, appellant's theory would apparently be that a notice to the prime contractor given any time prior to June 1, 1957, would suffice to hold the prime contractor and his bonding company on the indebtedness owed by subcontractor A even though it was nine months overdue and not merely 90 days. This appears to the appellees to be a very novel interpretation of Section 270b(a) and one apparently which has not been advanced in any other reported cases.

The object of this section, including as it does the 90 day notice provision, is obviously twofold in nature. It is broadly for the protection of suppliers furnishing materials and supplies on government projects and also containing as it does a provision for the 90 day notice from the supplier to the prime contractor it has a further purpose of providing a method in which the prime contractor can protect against double payments on the account of defaulting subcontractors. As is stated in *United States, ex rel, Hargis v. Maryland Casualty*, D.C. Cal. 1946, 64 F. Supp. 522:

"In requiring that written notice of claim be given to the contractor, and not to the bonding company, within a definite time, the statute seeks to protect the contractor by making it possible for him to withhold moneys due to the subcontractor, in order to satisfy claims asserted by third persons."

See also *Bowden, et al, v. United States of America for the Use of Malloy, supra*.

The appellant in its brief at page 25 states the following in an interpretation of the statute in question:

"In the latter case it is required that the supplier give notice of his claim against the subcontractor to the prime contractor, within 90 days from the date on which said supplier furnished the last of the material

for which the claim is made." (Emphasis supplied by appellant.)

Appellant argues that the written notice of claim submitted by it on April 25, 1957, was in fact a claim for materials furnished by it on the job the last of which were furnished on March 12, 1957, and that all payments received by it from Construction Materials Company were rightfully applied by appellant to the whole indebtedness owing to it for materials supplied to the Ajo job, and not to the last of the materials which were actually furnished to Construction Materials Company. Unfortunately the facts and the law do not bear out the appellant in this argument. From June 13, 1956, to November 1, 1956, the appellant furnished supplies and materials on the job in question to a value of \$29,900.39 (R 295). These materials were admittedly furnished to Pioneer Constructors. From November 1, 1956, to March 12, 1957, the appellant furnished additional materials and supplies to the job in question of a value of \$12,553.02 (R 295). On December 29, 1956, it received the check of Construction Materials Company in the sum of \$4,723.37 with remittance instructions that the same was in payment of itemized invoices (Appellant's Exhibit No. 11a in evidence; R 284). On February 13, 1957, it received an additional payment from Construction Materials Company in the amount of \$3,417.74, likewise with instructions that the same was in payment of itemized invoices (Appellant's Exhibit No. 11b in evidence; R 284). And on April 12, 1957, it received an additional payment from Construction Materials Company in the amount of \$4,411.91, likewise with instructions that the same was in payment of itemized invoices (Appellant's Exhibit No. 11c in evidence). The total of these three payments is the sum of \$12,553.02 and constituted payment of all supplies and materials furnished by appellant on the job in question after November 1, 1956.

There are two things which conclusively refute appellant's assertion that it applied these payments against the whole of the account and not to the itemized invoices mentioned: 1) The chronological breakdown of the account as furnished to the attorney for appellees by appellant (Defendant, Ashton Company, Inc., Exhibit A in evidence (R 294) and defendant Ashton Company, Inc., Exhibit B in evidence (R 295-296-297)) which shows that the payments were applied against the invoices as instructed; and 2) the law as to the application of payments received where directions are given as to the application of the funds by the person making the payment. As is stated in the case of *Cameron v. Sisson*, 74 Arizona 226 at pages 230 and 231, 246 P.2d 189:

"The well settled rule is that where payment is given to a creditor on more than one account by his debtor, he may direct to which account he desires a particular payment to apply, but if at the time of paying the money he fails to make any such direction, the creditor has the right to apply the payment as he sees fit."

See also *Webb v. Crane Co.*, 52 Ariz. 299, 80 P.2d 698. *Valley National Bank v. Shumway*, 63 Ariz. 490, 163 P.2d 676. In the case of *Mumm v. Taylor*, 213 P.2d 836, the court stated in adopting and quoting from 39 Am. Jur. Sec. 110, page 792, as follows:

"It is a well settled principle of both the civil and the common law, which is universally applied, that a debtor owing more than one debt to a creditor or a debt composed of several items has the right to direct to which debt or debts or to which item of a single debt and in what amounts a payment made by him shall be applied. The reason for this rule is that up to the time of payment the money is the property of the debtor, and being such may be applied as he sees fit. If a debtor directs the application of a payment, the duty is there-

by imposed on the creditor, regardless of whether he does or does not agree or consent to the debtor's request, to apply the money as directed, or return it to the debtor, and if he fails to return it, it is regarded by law as having been applied as directed, no matter how the creditor in fact applied it, unless the improper application is subsequently ratified by the debtor. Thus it has been held that where, pending the adjustment of a disputed liability, the debtor sends his creditor money as a payment in full of the demand, it is the duty of the creditor to accept the money for the purpose for which it was offered, or to return it, and his refusal to return it will be deemed an election to accept it for the purpose offered."

Thus it can be seen that even if the appellant had not applied the payments received from Construction Materials Company in the way directed, they were bound, because of such direction, so to apply the payments or to return the money to Construction Materials Company. This, of course, they did not do.

At the time of giving the written notice in an attempt to comply with the statute on April 25, 1957, the appellant had thus been paid in full for all materials furnished after November 1, 1956, and its claim therefore was for materials, the last of which were furnished prior to November 1, 1956. Its notice of claim, therefore, even under the ingenious theory propounded by the appellant was not made within 90 days *from the date on which said supplier furnished the last of the materials for which the claim is made.*

APPELLEES' ANSWER TO APPELLANT'S ARGUMENTS II, III AND IV

These divisions of the appellant's arguments deal primarily with the question of whether the appellant, Apache Powder Company, had notice or knowledge of the fact that

Pioneer Constructors was no longer performing work on the Ajo job and that the party to whom they furnished materials and supplies was a separate distinct corporation, namely, Construction Materials Company, and whether the information it had was sufficient to put it on inquiry, and if so, was a diligent inquiry made. Much of the space taken up by the appellant in its brief for argument under these subsections deals with evidentiary matter and also what findings of fact were made by the lower court. It is well at this time and prior to getting into the arguments proper, for the appellees to point out certain discrepancies in the facts as set forth by appellant and the facts as found by the lower court and the actual testimony as appears in the record of the trial.

1. On page 28 and again on page 29 of appellant's brief the statement is made with reference to the record that the appellee, Ashton-Mardian Company, required that the work proceed under same management with the same personnel and equipment as under Pioneer Constructors' subcontract. This is directly contrary to the evidence. The actual question and the answer given by the witness Harold Ashton and which is cited by the appellant as substantiating this assertion is as follows (R 132) :

“Q. You were also questioned in regard to change in management, personnel, equipment and suppliers on this job after November 1, 1956. I believe you said there was no material change not due to change in the type of work performed. Was that a condition of your agreement with Skorpick and Moore to give them the subcontract to Construction Materials, a condition that the work proceed by the same management, personnel, equipment?

A. That wasn't a condition.”

2. Throughout the arguments II, III and IV appears the statement, alleged as a fact, that the appellant, Apache Powder Company, was informed that Construction Materials Company, Construction Division, was a division of Pioneer Constructors. It might be well to review the evidence upon which this assertion is made. The only witness to testify that this statement was made to him was witness Paul Negley, whose testimony appears on pages 242-243, Transcript of Record, together with the pencilled notations made by Mr. Negley and constituting a portion of Apache Powder Company's Exhibit No. 3 in evidence (R 280). The position of the notations on the pencilled slip and the added computations obviously made after the telephone call in question from Paul Swagerty are of themselves of interest and were probably of great value to the lower court in determining this particular fact. Against the testimony of Mr. Negley, there is, in addition to the physical makeup of the notations above mentioned, the direct testimony of Paul Swagerty denying they were so informed (R 249 to R 260).

The findings of fact of the lower court (R 66 to R 75) and in particular findings No. 12 and 16 (R 70-71-72) show the court did not find as a fact that Apache Powder Company was so informed and in fact the only conclusion to be drawn from said findings is that the court actually found that they were not so informed. Rule 52a of the Federal Rules of Civil Procedure, 28 USCA 13, provides "Findings of fact should not be set aside unless clearly erroneous and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses."

This court in the case of *Carr v. Yokohama Specialty Bank, Limited, of San Francisco*, C.C.A. Cal. 1953 9th Cir., 200 F.2d 251 in dealing with this section of the rule has held that where evidence is conflicting, trial court has the duty to apprise all facts, adduce the proof and it is not clearly

erroneous for the court to choose between two permissible and conflicting views as to the weight of the evidence and appellate court may not dispute such a choice by the trier of facts.

3. It should be pointed out that in appellant's argument No. II a great deal of emphasis is given to the admitted fact that the two subcontracts involved, that to Pioneer Constructors, which was terminated as of November 1, 1956, and that to Construction Materials Company, which originated as of November 1, 1956, concerned the same items of work, the only difference being the difference in quantities to be performed or supplied. The appellant, however, had no knowledge of the contents of the contract with Pioneer Constructors until long after the present controversy had jelled (R 218-219). No logical reason is advanced by appellant, nor can the appellees find any, why this fact would render the rights of the parties hereto any different than had the Construction Materials Company subcontract called for more, less or different work.

Because the arguments under subsections II, III and IV of appellant's brief deal primarily with notice or knowledge, it would be well to review at this time what actual information, notice or knowledge appellant had as to the identity of the subcontractor with whom it was actually dealing, at least after December 3, 1956. (Appellant had no direct contractual relations either express or implied with the appellee Ashton-Mardian Company (R 73-74).)

1. On December 4, 1956, appellant received a telephone call from Paul Swagerty, the person with whom they had had almost exclusive contact in the sale and shipment of their supplies and materials on this job, (R 239) in which it was informed that the balance of the blasting materials and supplies to be sent to the Ajo job were to be billed

to Construction Materials Company, Construction Division (R 251-252, R 243, R 280-281). The original pencilled order notes taken by Mr. Negley (R 280-281) were set up in accordance with this information and request and later changed by instructions from Mr. Henderson, General Manager of the company (R 280-R 282).

2. On or about December 10, 1956, it received a call from Melvin J. Simmons in which he explained to the appellant that "powder being sent to the Ajo job should be billed to Construction Materials because they were doing the work" (R 166). Receipt of this telephone call was denied by the appellant but stands as conflicting testimony on this point.

3. On December 29, 1956, appellant, Apache Powder Company, received the check of Construction Materials Company in the amount of \$4,723.37 in payment of individual invoices billed by appellant to Pioneer Constructors (R 284).

Also to be considered in evaluating the notice and knowledge of appellant, Apache Powder Company, to the change in the subcontractor to whom they were supplying materials is the prior knowledge of the General Manager of appellant, Robert L. Henderson, of the existence of Construction Materials Company, not, as asserted, a division of Pioneer Constructors, but as an affiliated company (R 226-227).

Based on the above facts, the lower court made its findings of facts Nos. 12, 14, 15, 16 and 17 (R 70-71-72). The general rule as to circumstances of this kind is found in 39 Am. Jur., Section 12, page 238, as follows:

"12. Means of Knowledge as Notice.—Means of knowledge and knowledge itself are, in legal effect, the same thing where there is enough to put a party on inquiry. Knowledge which one has or ought to have under the circumstances is imputed to him. When a

party has information or knowledge of certain extraneous facts which of themselves do not amount to, nor tend to show, an actual notice, but which are sufficient to put a reasonably prudent man upon an inquiry respecting a conflicting interest, claim, or right, and the circumstances are such that the inquiry, if made and followed up with reasonable care and diligence, would lead to the discovery of the truth, to a knowledge of the interest, claim or right which really exists, then the party is absolutely charged with a constructive notice of such interest, claim, or right. In other words, whatever fairly puts a person on inquiry is sufficient notice where the means of knowledge are at hand; and if he omits to inquire, he is then chargeable with all the facts which, by a proper inquiry, he might have ascertained. A person has no right to shut his eyes or his ears to avoid information, and then say that he had no notice, he does wrong not to heed the 'signs and signals' seen by him. It will not do to remain wilfully ignorant of a thing readily ascertainable, and it is no excuse for failure to make an inquiry, that if made, it might have failed to develop the truth. It has been said that want of actual knowledge in such a case is a species of fraud."

Further in 39 Am. Jur., page 241, Section 15, the following is stated:

"15. Nature of Facts Exciting Inquiry.—Notice of facts putting one on inquiry is notice of the facts which such inquiry would have revealed. It is impossible, however, to lay down a general rule by which to determine what facts are sufficient to excite inquiry. Each case must, to a great extent, be decided on its own facts. It has been said that notice sufficient to put a person on inquiry need not contain complete information on every fact material to his knowledge. To charge one with notice, however, the facts must be such

as ordinarily to excite inquiry with reference to the particular fact which the inquiry is designed to elicit."

In light of the foregoing quotations, it is well to review the situation from the appellant's position at the time it received each of the above mentioned items of information, notice or knowledge. On December 4, 1956, the appellant had been supplying to Pioneer Constructors blasting materials and supplies from June 13, 1956 on an open account basis under terms requiring payment in cash in 30 days after delivery (R 218). It had received no payments whatsoever on this account (R 220 and R 294). On December 4, 1956, it received an order from a different corporation, Construction Materials Company, with the information that the balance of the job should be billed to the second corporation (R 252). On or about December 10, 1956, when the telephone call from Melvin J. Simmons was received it had within its knowledge all of the above named facts together with the added impetus of the information contained in Mr. Simmons' telephone call. On December 29, 1956, it had all of the aforementioned information together with the added fact that the second corporation, Construction Materials Company, was actually paying for materials and supplies furnished to the Ajo job and that such payments were being made on an invoice payment basis and not as a payment on account for all of the materials and supplies furnished on the job.

Let us now examine what the appellant did with this information and also what information it could have elicited by the simple means of one telephone call, one letter or one conversation with a representative of either Pioneer Constructors, Construction Materials Company or Ashton-Mardian Company.

Mr. Henderson, General Manager of the appellant, stated that all that he did was consider the matter, discuss the

situation with his accounting department and also have his representatives in the field see if the job was progressing without interruption (R 234). Apparently even the representatives in the field did not see fit to make any inquiry whatsoever of the people on the job doing the type of work which had formerly been performed by Pioneer Constructors. No further inquiry was even made of Paul A. Swagerty (R 256).

If Mr. Henderson or any other representative or employee of the appellant had seen fit to make one of the telephone calls or write one of the letters or contact one of the parties above suggested, he and the appellant would have found out that all materials which it furnished to the Ajo job, at least after December 4, 1956, had been ordered by Construction Materials Company, received by Construction Materials Company and used by Construction Materials Company and that the defendant, Pioneer Constructors, had not ordered or received or used any of the materials furnished by appellant, at least since December 4, 1956, and that as a matter of fact Pioneer Constructors had ceased to do any work on the Ajo job after October 31, 1956 and that all work done on the job thereafter was being performed by Construction Materials Company. It is the appellees' position that the knowledge, information and notice in the possession of the appellant was sufficient under the law to put it on inquiry as to the details of the change-over in customers on the Ajo job and that the acts taken by them in making inquiry were not sufficient to relieve them of their duty to ascertain the true facts.

It should be noted that the appellant, Apache Powder Company, admitted that the information which it had received was sufficient to make it give consideration to its future course of dealing on the Ajo job (R 230). The true

question then is not whether the appellant, Apache Powder Company, had sufficient information or notice to put it on inquiry, because it is admitted that it did give the matter consideration and made an investigation of sorts, but whether it used due diligence in making its inquiry. The appellees submit that it did not and the District Court so found (R 72).

The rule with respect to the duty to make inquiry is well stated in 66 C.J.S., Notice, Section 11b (2) page 645, as follows:

“When a person has notice of circumstances which put him upon inquiry, and he actually makes due inquiry into the circumstances and either fails to discover the existence of any rights in conflict with his own or becomes satisfied that the suspicions which have been awakened are unwarranted, or that a change in the circumstances has obviated the grounds of his apprehension, he is to be regarded as having acted bona fide and without notice of the fact.”

The lower court found as a fact that appellant, Apache Powder Company, did not act with ordinary prudence in making an investigation under the circumstances. In the case of *Reconstruction Finance Corporation v. Cody Finance Co.*, C.C.A. 10th Cir., 214 F.2d 695, the court, in commenting on the findings of the lower court that a bona fide inquiry had been made, stated:

“Whether the finance company made a bona fide inquiry, assuming a duty rested upon it to make such an inquiry, presented an issue of fact to be determined from all the facts and circumstances before the trial court. As stated, we think the facts as outlined sufficiently support the court’s findings and conclusions of law and the judgment based thereon and under the well established rule of this court such findings and conclu-

sions will not be disturbed on appeal, unless clearly erroneous.”

The court cites as authorities the following cases:

Mitton v. Granite State Fire Insurance Company,
C.C.A. 10th Circuit, 196 F.2d 1998;

Jones v. Grinnel, C.C.A. 10th Circuit, 179 F.2d 873;

Wyoming Railroad Company v. Harrington, C.C.A.
10th Circuit, 163 F.2d 1004.

A very interesting argument is advanced by the appellant at the top of page 39 of its brief when it is stated as follows:

“In connection with the information that it was a division of Pioneer Constructors, the very name Construction Materials Company, Construction Division, indicated that the organization was a division of some larger corporation * * *”

The very same argument could be advanced that the name General Motors Corporation, Buick Division, would indicate that General Motors Corporation was a division of some larger organization.

ANSWER TO ARGUMENT V

Suffice it to say that the cases cited by the appellant in this argument are without doubt the law on the subject insofar at least as they authorize a liberal construction of the statute. Appellees point out, however, that the purposes and objects of the act are twofold in nature and not entirely onesided, as the quotes in the appellant’s brief would indicate. This fact was well stated by this court in the case of *Bowden, et al. v. United States of America for the Use of Malloy*, supra, where the court stated as follows:

“It cannot be doubted that one purpose of Congress in enacting the Miller Act was the protection of laborers

and materialmen. But it is clear too, we think, from the mechanics provided in the Act for its operation and the accomplishment of its purpose, that it was the intent of Congress to fix a time limit after which the prime contractor could make payment to the subcontractor with certainty that he would not thereafter be faced by claims of those who had supplied labor and materials to the subcontractor."

ANSWER TO ARGUMENT VI

In Argument VI appellant is urging the court to overrule its own decision in the case of *Bowden, et al. v. United States of America for the Use of Malloy*, supra, and follow the earlier decision of the Fifth Circuit in the case of *Houston Fire and Casualty Insurance Company v. United States for the Use of Trane Company*, C.C.A. 5th Cir., 1954, 217 F.2d 729, and hold that the provisions of the Miller Act which require a supplier to a subcontractor to give written notice to the prime contractor are meaningless and permit recovery on satisfactory proof of oral notice.

The question involved under this division of appellant's argument is actually twofold in nature and appellees believe it can be best stated as follows:

1. As is stated by appellant: "In any event is specific and unquestioned oral notice given by a supplier to the prime contractor of the supplier's claims against the subcontractor sufficient notice under the Miller Act if such notice is given within 90 days after the delivery of the last of the materials to the subcontractor?" and

2. If oral notice is held by this court to constitute compliance with the statute then was the oral notice in this case given by the appellant, Apache Powder Company, to the appellee, Ashton-Mardian Company, on March 19, 1957, given within the time limit as prescribed by the statute?

Appellees submit that the answer to both of the foregoing questions is no.

No language could be more specific and definite than that of the Miller Act which requires "giving written notice to said contractor within ninety days * * *". While it is true that the Miller Act is remedial in nature and as such should be liberally construed, and that Federal courts on numerous occasions have upheld liberal construction of the Miller Act, we can find only one case, namely, *Houston Fire and Casualty Insurance Company v. United States for the Use of Trane Company*, supra, in which a court went so far as to hold that the requirement of written notice could be dispensed with provided oral notice could be satisfactorily proved. If this case is carried to its logical conclusion it would dispense with any writing whatsoever since, although it involved a subsequent writing, its reasoning is that satisfactory proof that oral notice was brought home to the principal contractor is sufficient.

It is interesting to note that the Court of Appeals for the Fifth Circuit itself apparently had serious doubts as to the soundness of this conclusion since the Court stated:

"It is true that the statute is carefully and meticulously phrased, and if this were a matter of first impression we might find difficulty in coming at once to the conclusion that what was done in this case was a sufficient compliance with it. However, the decisions under the statute, and particularly *Coffee v. United States for the Use and Benefit of Gordon*, supra, (157 F2d 968) have made it clear that it was."

We believe that the court misconstrued the *Coffee* case since as we read that decision and as this court construed the *Coffee* decision in the *Bowden* case, supra, the *Coffee* case did not hold that written notice to the prime contractor was unnecessary.

With the decision of the Fifth Circuit before it this court squarely held in *Bowden, et al. v. United States of America for the Use of Malloy*, supra, that written notice is necessary, the court stating:

“The appellee asserts, correctly enough, that the Miller Act is remedial in nature and entitled to a liberal construction in order to effectuate the legislative intent to protect those whose labor and materials go into public projects. He then argues that since the letter from Hickey gave the prime contractor all the information which it would have obtained if Malloy had given it the written notice provided by the statute, the principle of ‘liberal construction’ requires that we hold the latter notice was unnecessary. But this argument goes too far, too fast. It overlooks entirely the fact that the statute makes the requirement of written notice from the supplier a condition precedent to a right of action on the bond; and no rule of liberality in construction can justify reading out of the statute the very condition which Congress laid down as prerequisite to the cause of action.”

The court further stated in Note 10 thereto:

“We are aware that *Houston Fire and Casualty Insurance Co. v. United States for Use and Benefit of Trane Company*, 5 Cir., 1954, 217 F2d 727 is contra, but we do not consider the case soundly decided and, accordingly, do not follow it.”

The facts in the *Houston* case were that oral notice was given and a written acknowledgment thereto was made. In the *Bowden* case the claimant on numerous occasions notified the prime contractor of the claim and numerous conferences were held in attempts to obtain payment, and the defaulting subcontractor had given a letter in writing to the prime contractor setting forth the details. It would

appear that under the doctrine of the *Houston Fire and Casualty Insurance Company* case the latter writing would have been sufficient combined with the undisputed proof of the oral notice but as this court stated that while the Fifth Circuit decision was contra, this Court did not choose to follow it.

We respectfully submit that the reasoning in the *Bowden* case is much sounder than that in the *Houston* case. The latter, it would appear, carried the doctrine of liberal construction to unjustified limits by completely reading out of the statute the requirement for written notice to the extent that the court rendering the opinion, itself expressed doubts as to its soundness. This court, on the contrary, considered the question squarely, reached the logical conclusion that the statute meant what it said and refused to follow the other case.

In the present case there was no writing of any kind from the appellant, Apache Powder Company, to the appellee, Ashton-Mardian Company, given with the intent that the same should constitute notice under the Miller Act prior to April 25, 1957. It is interesting to note that there was a writing originating from the appellant to the attorney for the appellees on April 12, 1957, which letter is printed in full in the record at pages 295-296-297 and 298 and which could have probably constituted notice if given timely, under the Miller Act, except for the last paragraph therein which is as follows:

"If we determine that the shipment of March 12, 1957 will be the last to be made on the subcontract, we will in due time make formal claim under the Federal Statutes against you as the general contractors with copies to your bonding companies and to U. S. Army Corps of Engineers."

It is interesting to note that the appellant did not deem the same as constituting notice under the Miller Act and now attempts to satisfy the statute with an oral notice even previous to the letter of April the 12th. Can appellant state, "This writing is not a notice under the Miller Act and, we will subsequently give you notice." and then at a subsequent date contend that notice under the act had been previously given? Appellees submit that they cannot.

Question No. 2: "If oral notice is held by this court to constitute compliance with the statute then was the oral notice in this case given by the appellant, Apache Powder Company, to the appellee, Ashton-Mardian Company, on March 19, 1957, given within the time limited as prescribed by the statute?". Let us analyze the evidence and law as to whether a notice of March 19, 1957 is within the time limited by Section 270b(a). The evidence shows that from and after November 4, 1956, Construction Materials Company did in fact perform all the labor on the Ajo job for which supplies from the appellant were furnished and Pioneer Constructors did in fact cease to do any work on the job after October 31, 1956 (R 157). The evidence further discloses that the appellant received sufficient information and notice to put it on inquiry as to the true identity of its customer on the Ajo job on December 4, 1956. The question then arises, assuming that the information received by the appellant on December 4, 1956, was not sufficient to constitute notice to them of the true fact situation but was sufficient to put them on inquiry as to the true fact situation, how long should the appellant be allowed to make such inquiry in an attempt to ascertain the true facts before being deemed to have notice. The rule with respect to this time element is set forth in 66 C.J.S., *Notice*, Section 11b (3), page 645, as follows:

“A person put on inquiry by facts is to be allowed a reasonable time in which to make such inquiry before being affected with notice. Neither law nor equity will impute to a person a knowledge of facts which he has not had a reasonable opportunity to ascertain. What constitutes a sufficient lapse of time for notice depends on the circumstances of the case. If one takes but a short time for pursuing his inquiries, he cannot afterward avoid the effect of the notice by claiming that he did not allow himself a reasonable time for investigation.”

As has been pointed out in previous argument all that would have been required of the appellant to learn the true fact situation would have been a direct inquiry to either the appellee, Ashton-Mardian Company, or to Pioneer Constructors or Construction Materials Company, none of which was done. Would a reasonable time in which to make such inquiry be one day? One week? Ten days? The appellees submit that no longer period than ten days should be allowed under the circumstances, in which case the appellant should be bound as being affected with the notice no later than December 14, 1956. A notice of any kind given on March 19, 1957 thus does not fall within the required 90 day period.

The appellant would have this court hold that the 90 day period in which it is mandatory upon the supplier to give notice to the prime contractor should, in this instance, be from a delivery made by the appellant on December 20, 1956. Appellees submit that this is not and should not be the law. The evidence shows that the lower court found that the last of the materials and supplies furnished to the defaulting subcontractor, Pioneer Constructors, and used by it was delivered prior to November 4, 1956, and in any event, prior to December 4, 1956. In accordance with the

provisions of the Miller Act, claim must be submitted within 90 days from “* * * the date on which such person did or performed the last of the labor and furnished or supplied the last of the material for which such claim is made, * * *”. The theory adopted by the lower court in the trial of this action and as expressed by the court is set forth at pages 193 to 195 of the Transcript of Record. Assuming for the purposes of this argument that this theory is a proper one, does it follow that lack of notice as to the change of the actual identity of the customer of the appellant extends the period of claim for a full 90 day period after such notice? Appellees submit that it does not. Appellees further submit that the most that this fact situation should do is to permit the supplier to submit his claim within a reasonable time after the receipt of such notice and within 90 days from the date on which the last of the supplies were furnished and if, and only if, such reasonable time allowed will extend the 90 day period should such period be extended.

Inasmuch as the method of making claim is so simple a matter under the Miller Act, it would appear that 30 days would be ample allowance. The time limit under this theory would thus expire on February 1st, or at the latest, March 4, 1956 (R 71-72). No notice of any kind, either written or oral, was sent by the appellant to the appellees prior to this date.

The court should not lose sight of the fact, as stated in the early part of this argument, that without question the party ordering, receiving and using the materials and supplies supplied by the appellant, at least on and after December 4, 1956, was Construction Materials Company and not Pioneer Constructors.

CONCLUSION

Appellees respectfully submit that under the evidence and law applicable thereto, the appellant did not comply with the conditions precedent to a right of action against the appellees under Act of Congress of August 24, 1935, c. 642 §§ 1, 2, 49 Stat. 793, 794, 40 U.S.C.A. §§ 270a, 270b, and thus is not entitled to recover as against them.

The judgment of the District Court should be affirmed.

Respectfully submitted,

HALL, CATLIN & JONES

By HAMILTON R. CATLIN

CONNER & JONES

By A. O. JOHNSON

Attorneys for Appellees

No. 16,052

United States Court of Appeals

For The Ninth Circuit

APACHE POWDER COMPANY, a
corporation.

Appellant,

v.

THE ASHTON COMPANY, INC.,
CONTRACTORS AND ENGINEERS,
formerly ASHTON BUILDING COM-
PANY, and MARDIAN CONSTRUC-
TION COMPANY, corporations
engaged in Joint Venture as ASH-
TON-MARDIAN COMPANY; and THE
TRAVELERS INDEMNITY COMPANY,
a corporation,

Appellees,

Appeal from the
United States Dis-
trict Court for the
District of Arizona

APPELLANT'S REPLY BRIEF

EVANS, KITCHEL & JENCKES
363 North First Avenue
Phoenix, Arizona
Attorneys for Appellant

FILED

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trict Court for the
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APPELLANT'S REPLY BRIEF

STATEMENT OF THE CASE

In appellees' brief they respectfully submit that appellant has stated as facts matters which are either contrary to the evidence or upon which the evidence is conflicting and on which the trial court resolved the conflict adverse to appellant's contention.

Appellant admits that it inadvertently made one statement contrary to the evidence, the one that Ashton-Mardian Company required the work to be done by Construction Materials Company to proceed under the same management and with the same personnel and equipment as under the Pioneer Constructors subcontract (R 132), but submits that the significance of the matter is not whether Ashton-Mardian Company made it a requirement, but that the work did proceed under the same management and with the same personnel and equipment.

On the other hand, appellant respectfully submits that appellees have lumped together and confused (1) the facts in evidence which, until March 19, 1957, were known only by Ashton-Mardian Company, Pioneer Constructors, and Construction Materials Company, and were not actually known to appellant prior to March 19, 1957, (2) the facts in evidence actually known to appellant prior to March 19, 1957, and (3) the findings of fact of the trial court which appellant has contended and still contends were incomplete or were not supported by the evidence and are contrary thereto. Appellees also have stated as facts a number of matters which are not supported by the evidence and are contrary thereto, and in presenting facts in support of their arguments have consistently failed to mention other facts which are material and pertinent to the points discussed.

Practically all of the facts in evidence are admitted or are not in dispute, and thus there is little or no conflict in the testimony. It is of utmost importance, however, to determine what facts actually were known to appellant prior to March 19, 1957, in order to decide what notice or information should be imputed to it, if any, and in order to decide what duty, if any, was imposed upon appellant to investigate and ascertain the other facts.

The only way that this can be done fairly and logically is to consider all the facts and circumstances, to marshal the facts in their chronological order, to consider them in their proper relation to each other, and particularly to consider the progressive

development of the of the situation step by step, relating each item of information received by appellant to the situation then existing, and relating successive items of information received by appellant to the situations previously existing and those then existing. Appellant respectfully submits that this has been done by appellant in its opening brief but was not done by appellees in their answering brief, and on the contrary that appellees throughout their arguments consistently have lumped all the facts together.

To avoid repetition, and to call attention to these matters in connection with the arguments to which they are pertinent, appellant will not discuss them as a part of its reply to appellees' statement of the case, but as parts of its reply to appellees' argument.

REPLY TO ANSWER TO ARGUMENT I

The bases of appellant's Argument I are that, as far as appellant knew or was charged with knowing, it was at all times dealing with one subcontractor and was supplying the material to that one subcontractor, that it had only one account with respect to the Ajo job, that all charges for material were made to that one account and all payments were credited to the balance due on that account, that the last of the material furnished on the Ajo job on March 12, 1957, and charged to that account was part of the material for which the claim was made, and that its action was for the balance due on that account.

Appellees' analysis of appellant's Argument I is wholly inaccurate, and the example given of a supplier furnishing material to three different subcontractors, known to the supplier to be different subcontractors, during three successive periods, is absolutely inapplicable. Appellees ignore and attempt to avoid the fact that appellant was informed by Construction Materials Company that it was a division of Pioneer Constructors, and that appellant did not then know Construction Materials Company was claiming to be an independent subcontractor operating under a new subcontract.

Appellees also ignore and attempt to avoid the facts that the only account appellant had on the Ajo job was with Pioneer Constructors (R 214, 215); all the material was covered by factory orders and invoices addressed and mailed to Pioneer Constructors; all the material was shipped to and receipted for in the name of Pioneer Constructors (R 191, 192; Plaintiff Apache's exhibits 3 and 4 in evidence); all the material was charged to Pioneer Constructors and the monthly statements mailed to Pioneer Constructors (R 197); the application of the payments made by Construction Materials Company to Pioneer Constructors' account, and the current balances due on the account, were shown on the monthly statements (R 197, 198); and neither Pioneer Constructors nor Construction Materials Company objected to these applications and balances or claimed that the Construction Materials Company payments should be applied to the payment for the materials furnished after November 1, 1956 (R 197, 208).

In contending the facts do not bear out appellant's argument, appellees state that on December 29, 1956, appellant received a check of Construction Materials Company in the sum of \$4,723.37 with remittance instructions that the same was in payment of itemized invoices (Plaintiff Apache's exhibit 11a in evidence; R 284). But appellees failed to state that these invoices were for material ordered, invoiced, shipped, and receipted for in the name of Pioneer Constructors during the month of November, 1956, all prior to December 4, 1956, when Paul A. Swagerty requested that in the future the material be billed to Construction Materials Company. There is absolutely no evidence in the case to the effect that appellant ever was informed, prior to March 19, 1957, that Construction Materials Company took over the work on November 1, 1956. Thus, as far as appellant then knew, the payment of December 29, 1956, was on the account of Pioneer Constructors for material ordered by Pioneer Constructors.

Appellees also emphasize the payments by Construction Materials on February 13, 1957, and April 12, 1957. The February payment was received, with good reason, as another payment on

Pioneer Constructors' account, since the material was invoiced and shipped to and receipted for in the name of Pioneer Constructors. The April payment has no significance because it was made after appellant, on March 19, 1957, discovered that Construction Materials Company was claiming to act as an independent subcontractor under a new subcontract, except that there never was any objection that it was wrongfully applied to the Pioneer Constructors account.

Then on page 12 of their brief appellees state that there are two things which conclusively refute appellant's contention that it applied these payments against the whole of the account and not to the itemized invoices. The first, they say, is the chronological breakdown of the account

"as furnished to the attorney for appellees by appellant (Defendant, Ashton Company, Inc., Exhibit A in evidence (R 294) and defendant Ashton Company, Inc., Exhibit B in evidence (R 295-296-297)) which shows that the payments were applied against the invoices as instructed."

With respect to the first exhibit, the attorney for appellees is now testifying that the exhibit *as introduced in evidence* was *as furnished to the attorney for appellees by appellant*. There is no such testimony in the record.

On the contrary, Mr. R. L. Henderson, general manager of appellant, on cross-examination by Mr. Catlin, testified (R 221):

A. No, but let me explain if I may. That from our standpoint the money that we received from Construction Materials on Construction Materials' checks for Pioneer Constructors' powder invoices, from our standpoint we applied that against the balance, the entire balance of Pioneer Constructors.

Q. I don't want to be argumentative; that is not in accordance with this account then because you will note, Mr. Henderson, that the amount paid and shown as paid by Construction Materials here have been shown as being paying individual invoices, isn't that correct?

A. There are some invoices checked off on those.

Q. As being paid by invoices, as being paid by Construction Materials?

A. *There are some checked. Of course, I don't know who checked them.* (Emphasis added by appellant.)

With respect to the second exhibit, Mr. Henderson's letter of April 12, 1957 (R 295, 296, 297), the statement which appellees apparently are referring to is:

"Construction Materials Company's payments cover all shipments delivered since November 1, 1956 with the exception of 30c evidently due to an error in adding the amounts of the last 6 invoices."

This is not a statement that the payments made by Construction Materials Company were credited on the invoices for the material delivered after November 1, 1956, and as shown by Mr. Henderson's testimony given above there was no intention to do so and it was not done.

Furthermore, Hartford Accident & Indemnity Company Exhibit "C" (R 305), showing Apache Powder Company's statement to Pioneer Constructors dated December 31, 1956, shows that the payment by Construction Materials Company on December 29, 1956, of \$4,723.37, was credited as "Paid on Account" and credited to the balance of the account. Other monthly statements (Plaintiff Apache's exhibit 5 in evidence) show similar applications of the other payments or credit memos.

The second thing which appellees contend conclusively refutes appellant's assertion that it applied the Construction Materials Company payments against the whole of the Pioneer Constructors account, is their statements and citations of the law with respect to the application of payments.

The basis of this argument is appellees' assumption that the listing by Construction Materials Company on the remittance slips attached to its checks of the numbers of invoices issued to Pioneer Constructors constituted "instructions" to appellant to apply the payment on the invoices listed.

Appellees have assumed the burden and must bear the burden of establishing that the listing of invoice numbers is sufficient to constitute an application of the payment. This they have failed to do. They have not even mentioned this important element of their claim. They also have failed to mention and to avoid the effect of the fact that neither Pioneer Constructors nor Construction Materials Company objected to appellant's application of the payments, as shown by appellant's monthly statements, on the balance due from Pioneer Constructors, or claimed that the payments should be applied to the payment for materials furnished after November 1, 1956.

It also should be noted that Construction Materials Company, although claiming to be an independent subcontractor operating under a new subcontract, and not responsible for the obligations of Pioneer Constructors, never returned the factory orders, invoices, or monthly statements for correction, and never objected to or corrected the bills of lading before receipting for the material. These facts must be considered in construing the effect of its listing the Pioneer Constructors invoice numbers on its check remittance slips.

As shown by the foregoing, appellees have wholly failed to refute appellant's contention that appellant complied with the requirements of the Miller Act.

REPLY TO ANSWER TO ARGUMENTS II, III, AND IV

Before proceeding with their answer to Arguments II, III, and IV, appellees point out what they contend are certain discrepancies in the facts as set forth by appellant and the facts as found by the lower court and the actual testimony as appears in the record of the trial.

In their paragraph 2 on page 15, appellees refer to testimony of Paul Negley, the pencilled notation made by Paul Negley (R 280), and the testimony of Paul A. Swagerty. Appellees state:

"The position of the notations on the pencilled slip and the added computations obviously made after the telephone call in question from Paul Swagerty are of themselves of interest and were probably of great value to the lower court in determining this particular fact."

Appellant does not know what appellees mean by that vague innuendo, but it does know that Paul Negley directly and positively stated (R 243) that Paul A. Swagerty told him that Construction Materials Company, Construction Division, was a division of Pioneer Constructors.

Appellees further state:

"Against the testimony of Mr. Negley, there is, in addition to the physical makeup of the notations above mentioned, the direct testimony of Paul Swagerty denying they were so informed (R 249 to R 260)."

Paul A. Swagerty did testify that he did not recall telling Paul Negley that Construction Materials Company was a division of Pioneer Constructors (R 252), but on cross-examination he said he was not denying that he did (R 254).

In view of Paul Negley's direct and positive statement, not denied by Paul A. Swagerty, and the pencilled note, appellant respectfully submits that there is undisputed evidence that appellant was informed, in connection with the request for a change in the billing, that Construction Materials Company, Construction Division, was a division of Pioneer Constructors.

The fact that the lower court did not include such a finding in its findings Nos. 12 and 16 (R 70, 71, 72), does not warrant the conclusion that the court actually found that appellant was not so informed. And, in any event, having objected to finding No. 12 on the ground that it was not a complete finding of the material facts required by the undisputed evidence, and having objected to finding No. 16 on the ground that it was not supported by the evidence and was contrary thereto, appellant respectfully submits that they should be disregarded in this argument in the light of the record of the trial.

In their paragraph 3 on page 15, appellees apparently miss the purpose and fail to appreciate the importance of appellant's Argument II.

The facts in evidence set forth therein, many of which appellant had no knowledge until March 19, 1957, or until the taking of the deposition of Harold Ashton some months later, were set forth for the express purpose of showing they were such that appellant was given no reason to believe there had been any change in subcontracts or subcontractors, as it would have been under ordinary circumstances with the old management, personnel, and equipment moving out and the new moving in, and the new subcontractor making new arrangements with suppliers for material.

These facts are very important in considering the question whether the information appellant had was sufficient to put it on inquiry and, if so, whether diligent inquiry was made.

Appellees then proceed to deal directly with the question of appellant's notice or knowledge and in their paragraph 1 (a new series) on page 16 they emphasize the fact that Paul A. Swagerty was the person with whom appellant had had almost exclusive contact in the sale and shipment of material to the Ajo job, but they do not point out that Paul A. Swagerty, known to appellant as the purchasing agent for Pioneer Constructors, did not say he was no longer with Pioneer Constructors, or that he then was an employee of Construction Materials Company, or that the Pioneer Constructors subcontract had been terminated and a new subcontract given to Construction Materials Company. In requesting that the billing for that order of December 4, 1956, and future orders be made to Construction Materials Company, Construction Division, Paul A. Swagerty did not say that the work had been taken over by Construction Materials Company as of November 1, 1956. He did say, however, that Construction Materials Company, Construction Division, was a division of Pioneer Constructors, which naturally led appellant to believe that there had been no change in subcontractors or subcontracts.

Then appellees emphasize that in his pencilled note Paul Negley set up the billing in accordance with the request, but it was later changed by instructions from R. L. Hendeson, appellant's general manager. Appellees do not state here that this pencilled note also contained the words, "above is division of Pioneer Constructors," or set forth R. L. Henderson's explanations for changing the notation regarding the billing (R 212, 213, 235). There had been no communications from the offices of either Pioneer Constructors or Construction Materials Company; appellant was not informed that the Pioneer Construction subcontract had been terminated and a new subcontract given to Construction Materials Company; Construction Materials Company had made no arrangements to obtain material; and it was natural to assume that appellant was still doing business with Pioneer Constructors, the parent company.

It is obvious from the foregoing that the appellees are attempting to make their case on a sketchy, unrepresentative selection of the numerous pertinent facts in the record.

In paragraph 3 on page 17, appellees again refer to the receipt by appellant of the check of December 29, 1956, of Construction Materials Company, without setting forth the pertinent facts in connection therewith, which have previously been explained. Appellees also attach great importance to R. L. Henderson's prior knowledge of Construction Materials Company as an affiliate of Pioneer Constructors, seeking thereby to charge him with constructive notice of the distinct legal entities involved. Perhaps, if Mr. Henderson were a lawyer, it ought to have occurred to him to investigate whether he was dealing with separate legal entities, so as to preserve his company's rights in the event of future litigation under the Miller Act. However, Mr. Henderson was not a lawyer, but an ordinary businessman, whose understanding that Construction Materials Company was merely an affiliate of Pioneer Constructors was later reaffirmed by Paul A. Swagerty's telephone statement to the effect that the former was a division of the latter company. Appellees wholly fail to demon-

strate wherein Mr. Henderson's conclusions and assumptions were unreasonable or unwarranted; this they cannot in fact do, for it must be borne in mind that his conclusions and decisions were necessarily predicated upon his actual knowledge at the time, the most significant of which was that the *same people* were continuing to deal with his company and their *same equipment and personnel* remained on the jobsite.

On pages 17, 18 and, 19, appellees cite some phases of the rules of law relating to means of knowledge as notice, and nature of facts exciting inquiry, quoting from 39 *Am. Jur.*, Section 12, page 238 and 39 *Am. Jur.*, Section 15, page 241. There is no purpose in again citing here the other phases of the rules of law on these subjects cited by appellant in its opening brief. As it is said in the above-mentioned citation from Section 15, it is impossible to lay down a general rule by which to determine what facts are sufficient to excite inquiry. Each case must, to a great extent, be decided on its own facts. And appellees clearly indicate that, after all, the facts in this case determine the issues.

Then, beginning on page 19, appellees give their summation of the information, notice, or knowledge of appellant prior to March 19, 1957, when appellant for the first time was informed of part of the actual situation.

Appellant in its Argument III on pages 29 to 41 of its opening brief has shown in detail the progressive development of the situation step by step, relating each item of information received to situation then existing, and relating successive items of information received and the situation then existing to the previous ones. Appellant again respectfully submits to this Court that this is the only fair and logical method of proceeding to determine what knowledge or information appellant should be charged with, and in applying the rule that notice is imputed only on those facts that are naturally and reasonably connected with the fact known, and of which the known fact or facts can be said to furnish a clue, mentioned in appellants' citation from 66 *C.J.S.*, *Notice*, § 11b(4) (b), at page 646. Therefore, with respect to appellees

summation of facts, appellant will point out only the most important discrepancies.

On page 19 appellees state that on December 4, 1956, appellant had been supplying blasting material and supplies to Pioneer Constructors from June 13, 1956, on an open account basis under terms requiring payment in cash in 30 days after delivery (R 218), and that it had received no payments whatsoever on this account (R 220, 294). Appellant does not mention R. L. Henderson's reasonable explanation of this situation given in his testimony (R 224, 228, 229, 230, 231), detailed on page 37 of appellant's opening brief. Appellant contends that R. L. Henderson acted in this respect as any reasonably prudent businessman would act.

Appellees further state that on December 4, 1956, appellant received an order from a different corporation with the information that the balance of the material should be billed to that different corporation, Construction Materials Company, Construction Division. Appellees do not mention at this point the other pertinent facts about the relation between the two corporations.

Appellees again refer to the purported phone call from Melvin J. Simmons, which has been fully discussed previously in appellant's earlier brief, and then again refers to the payment by Construction Materials Company on December 29, 1956, without at this point giving the other pertinent facts about it.

It is obvious that appellees here again are attempting to make their case by selecting and correlating a few isolated facts. They are making no attempt to answer appellant's arguments in a fair and logical manner. And, appellant respectfully submits, appellees have not refuted in any substantial way the arguments presented by appellant.

Then appellees greatly emphasize the fact that appellant did not make one phone call, did not write one letter, and did not have one conversation with a representative of either Pioneer

Constructors, Construction Materials Company, or Ashton-Mardian Company before March 19, 1957. They make much of the point that if appellant had done so it would have learned all the actual and pertinent facts.

Appellant submits there was no duty on Mr. Henderson to do so, nor was his failure to do so unreasonable under all the circumstances then known to him. The real duty lay upon both Pioneer Constructors and Construction Materials Company to frankly notify appellant of the true circumstances surrounding their relationship and their subcontract with Ashton-Mardian Company. This they could so easily have done, but for some reason neglected to do, and now it is argued that they gave appellant's personnel sufficient hints and clues to put appellant on inquiry and place it under a duty to investigate. The argument answers itself, but we are compelled to go further.

Appellees failed to set forth R. L. Henderson's reasonable explanations for not phoning or calling one of these companies, and again here appellant contends that Mr. Henderson, under the circumstances, acted as a prudent businessman.

Furthermore, in this connection, appellees neglect to mention or consider the facts that Paul A. Swagerty, the purchasing agent, and Melvin J. Simmons, the secretary and office manager, of Construction Materials Company, apparently desirous of obtaining material on the credit of Pioneer Constructors, did not in their phone calls inform appellant that the Pioneer Constructors subcontract had been terminated, and that Construction Materials Company was acting as a new and independent subcontractor under a new subcontract from Ashton-Mardian Company. In the light of these circumstances, and Paul A. Swagerty's statement that Construction Materials Company, Construction Division, was a division of Pioneer Constructors, appellees' assumption that appellant could have learned the actual and pertinent facts from Pioneer Constructors, of which Melvin J. Simmons was formerly an officer and office manager, and Construction Materials Com-

pany, is not justified. And R. L. Henderson adequately explained (R 228, 229) why he did not contact Ashton-Mardian Company.

Then appellees contend that appellant admitted that the information it had received caused it to give consideration to its future course of dealing on the Ajo job and that, therefore, the real question is not whether appellant had sufficient information or notice to put it on inquiry, but whether it used due diligence in making its inquiry.

In this connection appellant accepts and adopts appellees' quotation from 66 C.J.S., *Notice, Section 11b (2)*, page 645, which is corollary to appellant's quotation from 66 C.J.S., *Notice, Section 11b (4) (b)*, page 646, which states that if a person actually makes due inquiry into the circumstances and fails to discover the existence of any rights in conflict, he is to be regarded as having acted bona fide and without notice of the fact.

Appellant has covered this point thoroughly in its Argument III on pages 29 to 41 of its opening brief, and here will only show some of the discrepancies and shortcomings of appellees' attempt to refute the facts and arguments.

Beginning at the bottom of page 19, appellees state:

"Mr. Henderson, General Manager of the appellant, stated that all that he did was consider the matter, discuss the situation with his accounting department and also have his representatives in the field see if the job was progressing without interruption (R 234)."

This certainly is a misrepresentation of the facts. In the first place, the accounting department kept a check to determine whether the factory orders (R 191), the invoices, and the monthly statements (R 197), which were addressed and mailed to Pioneer Constructors, were returned for correction, and whether the bills of lading were receipted in the name of Pioneer Constructors (Plaintiff Apache's exhibit 4 in evidence). None of the factory orders, invoices, and monthly statements were returned for correction, and all of the bills of lading were receipted for in

the name of Pioneer Constructors. As shown by Defendant Hartford's exhibits B, C, D, and E in evidence, and Defendant Hartford's exhibits F, G, and I in evidence, which contain the Pioneer Constructors invoice numbers, and also as shown by the testimony of Melvin J. Simmons (R 151), the factory orders, invoices, and monthly statements were delivered to Construction Materials Company.

In the second place, the periodic inspections by the Apache Powder Company field men disclosed, not only that the work was progressing without interruption, but that it was being carried on under the same management, with substantially the same personnel, and with substantially the same equipment (R 215), and that nothing occurred in connection with the progress of the work to raise any question as to whether or not there had been a change in subcontractors and subcontracts.

Furthermore, in spite of the fact that Apache Powder Company continued to address and mail its factory orders, invoices, and monthly statements to Pioneer Constructors, and to ship the material to Ajo under bills of lading addressed to and prepared for receipt by Pioneer Constructors, neither Paul A. Swagerty (R 255) nor anyone else again asked that the billing be changed.

All of these facts, and others marshalled in appellant's opening brief, are material and important to the question of whether appellant used due diligence in making its inquiry. And these, coupled with the testimony of R. L. Henderson (R 228, 229) relating to the caution he must use because he was in a competitive position with other suppliers, conclusively show that appellant acted as a prudent businessman under the circumstances.

Appellees point out that the lower court found as a fact that appellant did not act with ordinary prudence in making an investigation under the circumstances. In reply, appellant, who made this finding one of its grounds for appeal, respectfully submits that it has conclusively shown it is not supported by the evidence and is contrary thereto, and is clearly erroneous.

REPLY TO ANSWER TO ARGUMENT V

Appellees admit that the cases cited by appellant in this argument are without doubt the law on the subject insofar at least as they authorize a liberal construction of the statute, but point out, in a quotation from *Bowden v. United States For the Use of Malloy*, C.C.A. 9th Cir., 1956, 239 F.2d 572, 577, that it was the intent of Congress to fix a time limit after which the prime contractor could make payment to the subcontractor with certainty that he would not thereafter be faced by claims of those who had supplied material to the subcontractor.

Aside from the question of the sufficiency of the notice, treated under Argument VI, appellant here points out that Ashton-Mardian Company had actual notice within less than ninety (90) days after the actual termination of the Pioneer Constructors subcontract, and many months before final payment to Pioneer Constructors was required, of Apache Powder Company's claim. Ashton-Mardian Company agreed to the termination of the Pioneer Constructors subcontract in the latter part of November, 1956, but actually did not terminate it until January 8, 1957, and received oral notice on March 19, 1957, of Apache Powder Company's claim.

Thus, within the time limit fixed by Congress, appellees were actually protected against a double claim, and are seeking by means of a legal technicality to avoid payment of Apache Powder Company's claim.

REPLY TO ANSWER TO ARGUMENT VI

Appellees state that the question involved under this argument is actually twofold in nature, and then proceed to state two questions and unqualifiedly answer each with a no. Neither is complete and the two taken together fail to consider the pertinent facts. The question should be stated as follows:

Is specific and unquestioned oral notice given by a supplier to the prime contractor of the supplier's claim against the subcontractor

sufficient under the Miller Act if such notice is given within ninety (90) days after the delivery of the last of the material to the subcontractor, and if there is written unquestioned evidence of the receipt of the oral notice by the prime contractor?

Appellees state that appellant is urging the Court to overrule its own decision in the case of *Bowden v. United States For the Use of Malloy*, supra, and follow the earlier decision of the Fifth Circuit in the case of *Houston Fire and Casualty Insurance Company v. United States For the Use of Trane Company*, C.C.A. 5th Cir., 1954, 217 F.2d 727.

This is not correct. Appellant is urging this Court to distinguish the rulings in the *Bowden* case, in which the question of oral notice was not involved, in the light of the rulings necessary to that case and the facts in the present case, and to follow the decision in the *Houston* case, giving due consideration to the liberal interpretation in *Fleisher Engineering & Construction Co. v. United States For Use and Benefit of Hallenbeck*, N.Y. 1940, 61 S.Ct. 81, 311 U.S. 15, 85 L.Ed. 12, 14; *Liebman v. United States For Use of California Electric Supply Co.*, C.C.A. 9th Cir., 1946, 153 F.2d 350, 352; *Hawaii v. Mankichi*, 190 U.S. 197, 213, 23 S.Ct. 787, 47 L.Ed. 1016, 1021; and *Coffee v. United States for Use and Benefit of Gordon*, C.C.A. 5th Cir., 1946, 157 F.2d 968, 969; all cited in appellant's opening brief.

As appellant pointed out in its opening brief, the writing referred to in the *Bowden* case was sent by the subcontractor to the prime contractor, and the supplier had given no notice, oral or written, to the prime contractor. Furthermore, the Court pointed out that nothing in the letter informed the prime contractor that the supplier expected the prime contractor to pay the bill. Thus, the fact situation in the *Bowden* case can be clearly distinguished from the fact situation in this case, and Judge Walsh clearly based his decision on the facts (1) that there was no notice, oral or written, from the supplier to the prime contractor, and (2) that nothing in the letter informed the prime contractor that the sup-

plier expected the prime contractor to pay the bill. Therefore, the decision in the *Bowden* case should not control the decision in this case where (1) there is specific and unquestioned evidence of the giving of the oral notice by the supplier to the prime contractor, (2) there is written unquestioned evidence of the receipt of the oral notice by the prime contractor, and (3) no question exists as to the sufficiency of the notice.

Appellees state they believe this Court in the *Bowden* case misconstrued the *Coffee* case, since, as they say, the *Coffee* case did not hold that written notice to the prime contractor was unnecessary. What happened is that in the *Coffee* case the court said (157 F.2d 968, 969):

“Written notice is required to prevent misunderstanding and to afford certain evidence of the communication. The provisions for service afford means of making certain the fact of notice given, or of making a good service where the contractor can not be reached personally.”

And this Court in the *Bowden* case, in Note 9, cited the *Coffee* case in support of its statement (239 F.2d 572, 577) that:

“The giving of the written notice specified by the statute is a condition precedent to the right of a supplier to sue on the payment bond; the writing must be sent or presented to the prime contractor by or on the authority of the supplier; and the writing must inform the prime contractor, expressly or by implication, that the supplier is looking to the contractor for payment of the subcontractor’s bill.”

The decisions in the *Bowden* and *Coffee* cases can be reconciled. Each required a notice from the supplier to the prime contractor. Each required a writing to afford certain evidence of the communication. And, although the *Bowden* case requires that “the writing must be sent or presented to the prime contractor by or on the authority of the supplier,” this obviously was prescribed to rule out the notice in the *Bowden* case which was from the subcontractor to the prime contractor, not from the supplier to the prime contractor. If the word, “notice,” had been used instead of the

word, "writing," there would have been no difference in the rulings, and appellant submits there is no essential difference in the rulings.

On page 25, appellees state that in the *Bowden* case the claimant on numerous occasions notified the prime contractor of the claim and numerous conferences were held in attempts to obtain payment. This is correct, but these notices and conferences were before the subcontract was completed and before the last payment by the subcontractor to the claimant. Thus, appellees' reasoning on this point is fallacious.

Appellee calls attention to the fact that the Court in the *Bowden* case, in Note 10, called attention to the *Houston* case, but did not consider the case soundly decided and, accordingly, did not follow it. However, it is obvious that this comment was made because, in the *Bowden* case, the notice was not given by the supplier to the prime contractor, and under that circumstance it could not well follow the *Houston* case.

Then appellees attempt to show that the oral notice to the prime contractor on March 19, 1957, was not given within ninety (90) days after the last of the material, furnished to Pioneer Constructors, was delivered on the job. They point out that the lower court found that the last of the material furnished to Pioneer Constructors and used by it was delivered prior to November 4, 1956, and, in any event, prior to December 4, 1956.

However, the lower court found that Pioneer Constructors ceased work on October 31, 1956 (Finding 10; R 69, 70), and that on January 8, 1957, the subcontract of Pioneer Constructors was formally terminated (Finding 11; R 70). How, then, could it find that material delivered from November 1, 1956, to December 4, 1956, when Construction Material Company was performing the work, was furnished to and used by Pioneer Constructors, without finding that material delivered from December 5, 1956, to January 8, 1957, also was furnished to and used by Pioneer Constructors. The lower court's findings on the subject are clearly erroneous. It apparently was confusing the dates with respect to Pioneer Con-

structors' responsibility and liability on the job under its contract, with the dates with respect to notice which it imputed to appellant.

Appellant respectfully submits that, without regard to any notice or knowledge it may have had, Pioneer Constructors was the subcontractor on the job until January 8, 1957; the Construction Materials Company subcontract was not executed and delivered until that date; Ashton-Mardian Company held Pioneer Constructors responsible until that date; and Ashton-Mardian Company withheld payments to Construction Materials Company until after that date, when its bond was furnished. (R 125, 126) There was a delivery to the Ajo job on December 20, 1956, that delivery was the last one before January 8, 1957, and the oral notice on March 19, 1957, was within ninety (90) days from that delivery.

CONCLUSION

Appellant respectfully submits that appellees have failed to refute the facts and arguments presented by appellant in each of the three separate and different cases presented by appellant in its opening brief, under each of which appellant is entitled to judgment.

Therefore, judgment for the prime contractor and its surety should be reversed, and the District Court should be ordered to enter judgment against them and in favor of appellant.

Respectfully submitted,

EVANS, KITCHEL & JENCKES

By ALFRED B. CARR

RALPH J. LESTER

Attorneys for Appellant

No. 16053

United States
Court of Appeals
for the Ninth Circuit

JEAN DOBLER,

Appellant,

vs.

OLETA STORY,

Appellee.

Transcript of Record

FILED

DEC 17 1958

PAUL P. O'BRIEN, CLERK

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

No. 16053

United States
Court of Appeals
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vs.

OLETA STORY,

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

O. VINCENT BRUNO, ESQ.,

447 North First Street,

San Jose, California,

For Appellant.

LEWIS, SCHER & FERNANDEZ,

JOSEPH F. LEWIS, ESQ.,

226 South Murphy Avenue,

Sunnyvale, California,

For Appellee.

In the United States District Court for the
Northern District of California, Southern Division

Civil Acton No. 35867

OLETA STORY,

Plaintiff,

vs.

JEAN DOBLER, FIRST DOE, SECOND DOE
and THIRD DOE,

Defendants,

COMPLAINT FOR DAMAGES
(Personal Injuries)

Plaintiff complains of defendants, and each of
them, and for cause of action alleges:

I.

That she is a citizen of the State of California
and the defendant Jean Dobler is a citizen of the
State of Texas. The matter in controversy exceeds,
exclusive of interest and costs, the sum of Three
Thousand Dollars.

II.

That plaintiff is ignorant of the true names of
the parties sued herein as First Doe, Second Doe
and Third Doe, and she asks leave of the Court
that when the true names are made known to her
that she be permitted to insert the true names herein
with appropriate allegations in place of said ficti-
tious names used herein.

III.

That on October 2, 1955, at approximately 9:00 a.m., on a public highway, U. S. Highway 101, at its intersection with Sir Francis Drake Boulevard, in Marin County, California, the defendant Jean Dobler so carelessly and negligently operated a certain 1955 Chevrolet two-door sedan automobile so as to cause it to be driven against a certain 1953 Dodge two-door sedan in which plaintiff was riding as a guest passenger.

IV.

That at all times herein mentioned the defendant Jean Dobler was driving and operating the vehicle aforesaid with the consent and permission of the true owners, Jean Dobler, First Doe and Second Doe.

V.

That as a direct and proximate result of the carelessness and negligence of the defendants, and each of them, plaintiff Oleta Story sustained severe personal injuries, to wit: a severe injury to the neck and back, a severe head injury, great and severe nervous shock and great and severe physical and mental pain and suffering; and plaintiff is informed and believes, and upon such information and belief alleges, that these injuries are of a permanent nature; all to plaintiff's general damages in the amount of \$50,000.00.

VI.

That as a further direct and proximate result of the carelessness and negligence of the defendants,

and each of them, plaintiff Oleta Story has incurred necessary medical expenses for the care and treatment of said injuries, and will continue to incur medical expenses for a long period of time in the future; that plaintiff does not know the amount of these expenses at the present time, and she prays leave that when the same become made known to her she may be permitted to amend her complaint to insert the same with appropriate allegations.

VII.

That as a further direct and proximate result of the carelessness and negligence of the defendants, and each of them, plaintiff Oleta Story has incurred loss of earnings and impairment of earning capacity which at the present time is unknown to plaintiff, and she asks leave of the Court that when the same become known to her that she be permitted to amend her complaint with appropriate allegations.

As and for a Second, Separate and Independent Cause of Action, Comes Now the Plaintiff and Complains of Defendants Above Named. and Each of Them, and Alleges:

I.

Incorporates herein by reference as fully as though set forth at length, the allegations contained in paragraphs I, II, III, V, VI and VII of the first cause of action.

II.

That at all times herein mentioned defendant Jean Dobler was the agent and servant, and acting within the course of her employment of her employer, Third Doe.

Wherefore, plaintiff prays judgment against defendants, and each of them, as follows:

1. General damages in the sum of \$50,000.00;
2. Special damages for medical expenses according to proof;
3. Loss of earnings and impairment of earning capacity as proved;
4. Costs of suit;
5. Such other and further relief as the Court may deem just.

/s/ JOSEPH F. LEWIS,

Attorney for Plaintiff.

Duly verified.

[Endorsed]: Filed September 27, 1956.

[Title of District Court and Cause.]

ANSWER

Comes now the defendant Jean Dobler, and in answer to the complaint of the plaintiff on file herein, admits, denies and alleges:

I.

Denies each and every allegation contained in Paragraphs numbered III, IV, V, VI and VII of plaintiff's first alleged cause of action; and further answering the allegations contained in Paragraph numbered V, specifically denies that the plaintiff was damaged in the sum of \$50,000.00, or in any other sum, or at all.

II.

Answering the allegations contained in Paragraph numbered I of plaintiff's second alleged cause of action, answering defendant repeats and realleges each and every admission, denial and allegation hereinabove contained with reference thereto.

III.

Denies each and every allegation contained in Paragraph numbered II of plaintiff's second alleged cause of action.

As and for a Second, Separate and Distinet Defense,
Answering Defendant Alleges:

I.

That on the 29th day of November, 1955, the plaintiff for valuable consideration, released the defendant from all liability to the plaintiff on any and all claims of the plaintiff against the defendant which existed at the time of the said release, or which might thereafter arise against the defendant from or on account of anything done by the defendant prior to the date of the said release, and including the alleged claim set forth in the complaint.

As and for a Third, Separate and Distinct Defense to Both Causes of Action, and for the Defense of Contributory Negligence, Answering Defendant Alleges:

I.

That plaintiff was herself negligent and careless in and about the matters referred to in her said complaint, and that said negligence and carelessness on the part of the plaintiff proximately contributed to and was a proximate contributing cause of her damage, if any.

As and for a Fourth, Separate and Distinct Defense to Both Causes of Action, and for the Defense of Unavoidable Accident, Answering Defendant Alleges:

I.

That the injuries and damages sustained by plaintiff, if any, at the time and place of said accident, were the direct and proximate result of an unavoidable accident, or mere misadventure without negligence on the part of this defendant.

Wherefore, answering defendant prays that plaintiff take nothing by reason of her complaint on file herein, together with the costs and disbursements of this action, and for such other and further relief as to the Court may seem just and proper.

/s/ O. VINCENT BRUNO,

Attorney for Said Defendant.

Affidavit of service by mail attached.

[Endorsed]: Filed November 19, 1956.

State of California,
County of Santa Clara—ss.

O. Vincent Bruno, being first duly sworn, deposes and says:

That he is the attorney for Jean Dobler, the answering defendant in the above-entitled action; that he has read the foregoing Answer and knows the contents thereof; that the same is true of his own knowledge, except as to matters therein alleged on information and belief, and as to those, that he believes it to be true; that the reason this verification is made by your deponent is that the answering defendant is outside the county where said attorney has his offices.

/s/ O. VINCENT BRUNO.

Subscribed and sworn to before me this 15th day of November, 1956.

[Seal] /s/ JANE M. WISE,
Notary Public in and for the County of Santa Clara,
State of California.

[Title of District Court and Cause.]

FINDINGS OF FACT, CONCLUSIONS OF
LAW AND JUDGMENT

The above-entitled cause came on regularly for trial on December 30, 1957, and again on January 31, 1958, in the above-entitled Court, before the

Honorable O. D. Hamlin, presiding without a jury, plaintiff appearing in person and by her attorney, William J. Fernandez, and defendant appearing by her attorney, O. Vincent Bruno, and evidence, both oral and documentary, having been introduced, and said Cause having been submitted to the Court, the Court makes its findings of fact as follows:

Findings of Fact

I.

That at the commencement of the within action, plaintiff was a citizen of the State of California and defendant, Jean Dobler, was a citizen of the State of Texas.

II.

That on October 2, 1955, at approximately 9:00 o'clock a.m., on a public highway, to wit: U. S. Highway 101 at its intersection with Sir Francis Drake Boulevard, in Marin County, California, the defendant Jean Dobler negligently and carelessly operated her 1955 Chevrolet 2-door sedan, so as to cause it to strike the rear end of a 1955 Chevrolet coupe in which plaintiff was riding as a guest passenger.

III.

That as a direct and proximate result of the carelessness and negligence of the defendant, Jean Dobler, the plaintiff, Oleta Story, sustained injuries to her body, including injury to her neck, nervous shock and physical and mental pain and suffering,

all to plaintiff's general damage in the amount of \$2400.00.

IV.

That plaintiff, Oleta Story, has incurred necessary medical expenses for the care and treatment of the injuries mentioned in the paragraph above in the sum of \$265.00.

V.

That at the time that the plaintiff signed a release of all claims, releasing defendant from all liability for the accident of October 2, 1955, the plaintiff did not know or understand that the release signed by her covered her claim for personal injuries, and that the plaintiff believed that at the time she signed the release she was releasing only her claim for property damage to her 1955 Chevrolet automobile, owned jointly by plaintiff and her husband.

VI.

That plaintiff was not herself negligent and careless in and about the matters referred to in her complaint on file herein.

VII.

That the injuries and damages sustained by plaintiff were not the direct and proximate result of an unavoidable accident or mere misadventure.

Conclusions of Law

I.

That this Court has jurisdiction over all the parties to, and the subject matter of, this action.

II.

That the release signed by the plaintiff did not bar recovery by her in this action.

III.

That the plaintiff is entitled to judgment against the defendant for the sum of \$2400.00 general damages; \$265.00 special damages; and costs of suit.

Dated: March 24, 1958.

/s/ O. D. HAMLIN,

United States District Judge.

Lodged March 10, 1958.

[Endorsed]: Filed March 25, 1958.

In the United States District Court for the Northern
District of California, Southern Division

File No. 35867

OLETA STORY,

Plaintiff,

vs.

JEAN DOBLER, et al.,

Defendants.

JUDGMENT ON FINDINGS

The above-entitled Cause came on regularly for trial, William J. Fernandez appearing as counsel for plaintiff, and O. Vincent Bruno appearing for the defendant. A trial by jury having been expressly

waived, the cause was tried before the Court sitting without a jury, whereupon witnesses on the part of plaintiff and defendants were duly sworn and examined, and the evidence being closed, causes submitted thereon, and the Court made its findings and decisions in writing as follows: The Court finds that the plaintiff did not know or understand that the release signed by her covered her claim for personal injuries; the Court further finds that plaintiff is entitled to judgment against defendant Jean Dobler in the sum of \$2,665.00 and costs of suit. Said findings have been filed by the Court and it has been ordered that judgment be entered in accordance therewith. Wherefore, by reason of the law and the findings aforesaid,

It Is Hereby Ordered that plaintiff Oleta Story do have and recover from defendant Jean Dobler the sum of \$2,665.00 together with costs of suit in the sum of

Dated: This 24th day of March, 1958.

/s/ O. D. HAMLIN,
Judge.

Lodged February 26, 1958.

[Endorsed]: Filed and entered March 25, 1958.

[Title of District Court and Cause.]

NOTICE OF MOTION AND MOTION FOR
NEW TRIAL

To: Oleta Story, Plaintiff, and to Lewis, Scher &
Fernandez, Her Attorneys:

You, and Each of You, Will Please Take Notice that on the 10th day of April, 1958, at the hour of 9:30 o'clock a.m., in the forenoon of said day, or as soon thereafter as counsel can be heard, the defendant will move his Honor, Judge O. D. Hamlin, in his courtroom in the United States District Court of the Northern District of California, Southern Division, at the court house in the City and County of San Francisco, State of California, for an order vacating the judgment on findings heretofore filed herein under date of March 25, 1958, and for a further order granting a new trial to the defendant above named, and for such other order or orders as may seem just and proper.

This motion will be based upon the files, records and transcripts of testimony taken in this action, upon all the proceedings heretofore had herein, and upon the grounds that:

1. That the Court was manifestly in error in alleging as it appears from its written opinion upon which it rested its final determination that said release signed by said plaintiff was not a bar to any recovery herein.

2. That the findings are against the evidence.

3. That the findings are against the law.
4. That the Court erred in findings of fact that the Court herein had jurisdiction of the matter.
5. That the Court erred in entering judgment for the plaintiff.

Dated: This 31st day of March, 1958.

/s/ O. VINCENT BRUNO,
Attorney for Said Defendant.

Affidavit of service by mail attached.

[Endorsed]: Filed April 3, 1958.

[Title of District Court and Cause.]

ORDER

The defendants' motion for a new trial may be, and the same is, hereby denied.

Dated: April 21, 1958.

/s/ O. D. HAMLIN,
United States District Judge.

[Endorsed]: Filed April 22, 1958.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that the defendant Jean Dobler above named, hereby appeals to the United

States Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on the 25th day of March, 1958, and from each and every portion thereof.

Dated: May 7, 1958.

/s/ O. VINCENT BRUNO,

Attorney for Defendant and
Appellant Jean Dobler.

Affidavit of service by mail attached.

[Endorsed]: Filed May 13, 1958.

The United States District Court, Northern District
of California, Southern Division
No. 35867

OLETA STORY,

Plaintiff,

vs.

JEAN DOBLER, et al.,

Defendants.

Before: Hon. Oliver D. Hamlin, Judge.

TRANSCRIPT OF PROCEEDINGS

December 30, 1957

Appearances:

For the Plaintiff:

LEWIS, SCHER & FERNANDEZ, By
WILLIAM J. FERNANDEZ, ESQ.

For the Defendants:

O. VINCENT BRUNO, ESQ.

The Clerk: Oleta Story versus Jean Dobler, for trial.

Mr. Fernandez: Ready for the plaintiff.

Mr. Bruno: Ready for the defendant, and at this time I would like to request the Court, pursuant to a stipulation, that the affirmative defense relief which is alleged in the answer of the defendant, be tried prior to any trial on the merits, which I think would make a sensible proceeding.

The Court: Is that agreeable, counsel?

Mr. Fernandez: Agreeable, your Honor.

Mr. Bruno: Shall we proceed, your Honor?

The Court: Yes.

Mr. Fernandez: If the Court please, William J. Fernandez, attorney for the plaintiff. If the Court please, I would like to make one preliminary statement for the record:

I believe it is the usual rule in cases dealing with compromises and releases to show in some manner or other that you have made an offer to return the amount received. In this case, we have received \$100.

However, on the basis of our theory of the case, it is this, that we are not attempting to avoid the contract which has been made, but are trying to show that we did not make the contract which we apparently made. [3*]

In other words, we believed when we signed the release that we were only releasing our collision damages and not our rights to any injuries to our body, and on that basis and on the basis of civil

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

California cases which I have read, it is not necessary to make a tender of the amount received.

However, with this understanding in mind, for the record I make the official tender in Court to return the \$100 that we got for the collision coverage—for the record.

The Court: All right.

Mr. Fernandez: Will you take the stand, please, Mrs. Story?

Mr. Bruno: And the burden of proof is on the defendant, isn't that correct? I think the defendant should proceed.

The Clerk: State your appearance for the record.

Mr. Bruno: O. Vincent Bruno, attorney for the defendant, Jean Dobler.

As a preliminary statement, your Honor, I would like to outline just very briefly what occurred in this matter so that it may have a little more continuity for the Court:

At the outset, it would be clear that an automobile accident occurred at the Greenbrae intersection in the rural section of Marin County, in the State of California, on October 2, 1955, at approximately 9:00 o'clock p.m.

The evidence is rather clear that in the one car [4] being operated by Thurman B. Story, the husband of Oleta Story, the plaintiff in this proceeding, was driving Oleta Story, the plaintiff, together with some children. The other vehicle——

The Court: You say that the car was driven by the husband of the plaintiff?

Mr. Bruno: Yes, your Honor. And the plaintiff was riding in the car.

The driver I represent, Jean Dobler, is an Army nurse stationed in Marin County at the time, and she is now, incidentally, stationed in Germany, struck the rear of the vehicle of Mr. Story. This occurred on October 2, 1955, and I think it will become clear that on November 29, 1955, almost two months following the accident, a general release of all claims for personal injuries and property damage was signed by Mrs. Oleta Story, the plaintiff in this case. She was paid the sum of \$330.80 as consideration for the release, which sum has never been offered back to the defendant until this morning, a few minutes ago, and which offer I feel is a little late under the adjudicated cases.

Now, with reference to the law, I assume your Honor would prefer to hear the evidence first rather than argue the law.

The Court: Well, no, I would rather hear your theory first so that maybe I can understand the evidence a little better. [5]

Mr. Bruno: All right, your Honor.

Now, this is a general release, which I think the evidence will clearly indicate that it could be stipulated to, that Mrs. Story signed, and that she signed it at a time when she was of clear mind, she understood it, she could read it, and she had ample opportunity to read the release.

The evidence will show the release came in the mail from her own insurance company.

It will be shown in the evidence that the defendant, or the defendant's own insurance carrier or the defendant's agent, had absolutely nothing to do with Mrs. Story signing this release, that they never had any contact with her at all. She received this release of claim in the mail, and she signed it and had her husband sign it, and sent it back and subsequently received the consideration called for in the release.

The sanctity of a release under the law of the State of California is too obvious for me to go into, I think, your Honor, and the possible defenses that the plaintiff has against the effect of this release would seem to me to be, as developed by the interrogatories and the deposition of the plaintiff, to the general effect that she didn't know what she was signing. She doesn't claim any fraud, she doesn't claim any duress, she doesn't claim any unfairness, over-reaching. She doesn't claim any act whatsoever on the part of the defendant or defendant's agents.

She claims merely that, apparently, she didn't know what she was signing.

The evidence will clearly show that she knew she had sustained a whiplash injury of the neck, and I think it's a minor one, at the time the accident occurred. And the evidence will show that she signed a report indicating she had sustained a whiplash injury of the neck on October 4, two days after the accident, and signed this release willingly on November 29, 1955.

The release is duly witnessed by two witnesses, both of whom I believe were residents of a motel where the Story's were staying in Marin County at

the time, and the signatures were notarized by a Mr. Rutledge, a notary public, whom we have never been able to locate, but I don't think there is any question about it, about the acknowledgment of the signatures.

So the only defense that apparently is going to be presented is either that she didn't know the extent of her injuries, supposing she were injured at all, which the evidence will show is not true.

Secondly, according to the statement of Mr. Fernandez, that the plaintiff did not know what she was signing.

In California, there are two general defenses to the effect of a release, and the law is in conformity throughout the United States on the subject.

Generally, one, that there was no release at all [7] because of some fraud, duress, or over-reaching in the first instance, in which event you have a case of the release being void *ab initio*—at the outset there never was a release, never was a contract, or there was such a mutual mistake of fact—mutual mistake of fact—that there was never any meeting of the minds of the parties.

This apparently does not apply to this case and it's apparently not being alleged.

The second general classes of cases are those which are alleged in Section 1,689 of the Civil Code of the State of California, which provides that a party may rescind a contract, including, of course, a release, in six specific instances, one being where consent was obtained by mistake or fraud, duress, undue influence, and where this fraud and undue in-

fluence, and so forth, was exercised by the defendant, by the other contracting party, or through his compliance.

And the second general category is where, through the fault of the party against whom the decision is sought, there has been a mutual mistake of fact.

That is the second category.

The third category, if the consideration fails at the outset.

The fourth category is where consideration fails after the contract is made, a failure in consideration; the fifth category being where there is consent of all parties, [8] and the sixth being under circumstances outlined in Sections 1785 and 1789 of this Code. And those sections, your Honor, I know are not applicable. I can't refer the Court to the exact language of those.

Apparently what is being claimed here is the fact that there was some sort of mistake, but it was a unilateral mistake, a mistake on the part of plaintiff herself and no one else. There is certainly no mistake on our part. We clearly understand what was done, and clearly appreciated the fact and were satisfied with the result. So that there was no mutual mistake.

The release, the evidence will show, is written in plain English. It's a release of personal injuries and damage to property, loss of services, medical expenses, loss of damages of every kind, and it specifically states that the releasor has read and clearly understands everything in the release.

The release clearly states that, "The foregoing

release has been carefully read, we know the contents thereof, and sign the same as my own free act, and have not been influenced in making this settlement by any representation of the party or parties released.”

So if a mutual mistake in fact, or a mistake of fact, is alleged, they have failed for that reason. If it is a unilateral mistake, that is no defense—no defense at all. [9]

The second point, since this is the type of case where rescission must be had under the law, there has never been any rescission. We have never received an offer back of the \$100. We received it today in Court, which is certainly too late because the rights of the plaintiff are fixed as of the date of filing the complaint and the time the defendant filed its answer.

The rights are not fixed as of this time, so that the rescission required under the Civil Code must have been exercised before. And that I say because of the specific provisions of Section 1691 of the Civil Code of the State of California. This is a new section.

Rescission in 1691 of the Civil Code, your Honor, specifically provides that rescission, when not effected pursuant to a consent of all parties, can be accomplished only by the action on the part of the rescinding party of reasonable diligence to comply with the following rules. And this is the way rescission is accomplished.

One, when the rescinder promptly upon the discovery of the facts—when you rescind promptly

upon the discovery of the facts which entitle you to rescind.

Well, the accident occurred November 2, 1955. The release was signed on November 29, 1955, and we get a purported release here in December, 1957. I think that that does not fall within the category of "reasonable diligence" to exercise [10] the right of rescission that is required.

Secondly, in order to exercise this right of rescission, he must restore to the other party everything of value which he has received from him under the contract, which has never been restored—\$100, as Mr. Fernandez says, and I say it is \$380.80. That has never been restored to the defendant.

I say, therefore, to your Honor, that that is our theory of the law. Some of it is, of course, anticipatory because I don't know precisely the defense being proposed by the plaintiff. I assume it is what counsel has stated, that she didn't know what she was signing. If that is the defense, and if this is considered an opening statement, I would think I could submit the matter merely on the argument now, because as a matter of law, even if proved that she didn't know what she was signing although she had an opportunity to read it, that would be no defense.

Mr. Fernandez: I have an opening statement to make. I only made that prior statement to comport with one small segment of what I thought the law was. I believe some of the facts have been stated, but I think they need further amplification.

This accident which occurred was a rear-end type

of collision. We were rear-ended by the defendant. We were stopped at an intersection. At all events, to an outsider [11] looking at the case, it would seem to be a case of liability on the side of the defendant.

Now, in our evidence we will try to show that the negotiation for this entire release which was signed and which counsel has a copy of was conducted between Mrs. Story and her insurance company. It was her understanding through her conversations with her insurance company that when she signed the papers she was giving up only her rights in so far as claiming back the \$100 deductible which she had to pay to repair her automobile.

Now, we will show by testimony that the \$330 and so many cents which forms the consideration for this release of all claims was the property damage, the cost of repairs to the Story automobile.

We will further show that the release, right on its face, it shows that the insurance company, the American Insurance Company, was Mrs. Story's own insurance company. They signed the release also releasing any claim they had to property damage.

Now, it is our position that when Mrs. Story signed this release, she understood it to only cover any claim she may have had against the defendant on her automobile collision—excuse me, for her property damage. When she signed it for her company, it was necessary for her company to have this release in order that it could collect back its property damage [12] claim. She did not think that she was signing away all of her rights, because at the

time the release was signed, as counsel has pointed out, she was suffering physical injury. She was suffering pains to her neck. Whether minor or major, she was suffering them, and she did not intend to give up any claims she had to her physical trouble.

Now, on this state of facts, I present my theory of what the law is, what the law of California states on this particular type of thing.

Initially, under the Civil Code of California, Section 1550.7, that it is essential to the existence of a contract that there should be parties capable of contracting, that there be consent, et cetera.

Now, the important point is this, that there should be consent.

The next step, the essentials of consent: "The consent of parties to a contract must be free, mutual and communicated."

This is Section CCC-1565.

Section 1567 says: "Apparent consent, when not free. Apparent consent is not free when obtained through menace, fraud, undue influence or mistake."

Now, Section 1577 is called, "Mistake of Fact. Mistake of Fact is mistake not caused by neglect of a legal duty on the part of the person making the mistake, and consisting [13] of an unconscious ignorance or forgetfulness of a fact that is material to the contract; or, two, belief in present existence of a thing material to the contract which did not exist during the past existence, or such a thing which has not existed."

Now, counsel points out that this mistake could be either mutual or unilateral. He claims it is

unilateral, and he says that under that state of facts the law of California says you can't recover.

Well, I beg to differ with him.

According to the case of *Forest Lawn versus De-Jarnette*, 79 Cal. Ap. 601, and *Lepper versus Rat-terre*, 98 Cal. Ap. 245, and also Civil Code 1576, unilateral mistake is sufficient to rescind the contract.

Now, I have gone further than that, your Honor. I have researched several cases on the particular theory that we are going under, and I think that the leading case or the earliest case that I can find in California is the case of *Meyer versus Haas*, 126 Cal. 560. In this case, the plaintiff signed a release for \$25, which he thought covered loss of time only, but which actually released all claims. The Court held that the release could be voided. In other words, there was a jury trial and findings of fact that this was so, and on the trial the Court said that the release could be voided.

Now, there are other cases to the same effect. One which I think is closely in point to this case is *Raynale versus [14] Yellow Cab Company*, 115 Cal. Ap. 90. The case is where the plaintiff signed a release for \$45 for her damaged coat, believing it covered only the damages to the coat. The Court held the release was void because there was no contract because the minds never met, or at most, no contract beyond the boundaries of mutual intent.

Now, there are other cases. *Tyner versus Axt*, 113 Cal. Ap. 408. This is a case where the plaintiff signed the release believing the settlement was only

for medical bills. She did not understand it was intended to effect a general release for the defendant. Held, a finding of fact, that the release could be voided was sustained by the evidence, and they followed the ruling of *Smith versus Occidental*, 99 Cal. 462.

The Court: You seem to be awfully far back in your cases there, counsel.

Mr. Fernandez: I am working my way up, your Honor.

The Court: I haven't heard of a Cal. Ap. 2d or a Cal. 2d yet.

Mr. Fernandez: Here is a real recent one: *Jordan versus*, 23 Cal. 2d 469. Releases signed by the plaintiff. This is a husband and wife situation.

The plaintiff's father who had signed the release, had gotten to the 7th grade. He knew the settlement was final and was satisfied with it, but did not know that he had a right to anything except the items for funeral expenses and time lost, [15] which were the only subjects of discussion, and as he thought that those were all that the releases covered, held that the release could be voided.

Mr. Bruno: You are not quite citing that page correctly.

Mr. Fernandez: Well, there was probably some more if you want to cite it. I just took a brief capsule.

Mr. Bruno: The jury told the plaintiff that was all he was entitled to.

Mr. Fernandez: I think it was also on the ground of mistake, as I recall reading the facts.

Here's another one, Weiztein versus Thomason, 34 Cal. Ap. 2d 554. Plaintiff signed a release believing it was only for payment for auto repairs and medical to the date of the release. Held, a party signing an instrument will not be held by it unless he assented to it, and if he did not in reality assent, such want of assent can be shown in order to avoid the effect of his signature.

Here is another case which I think is very interesting: Mairo versus Yellow Cab Company, 208 Cal. 350.

The lower Court directed a verdict for the defendant. It appeared that in this case the plaintiff signed three releases, and the plaintiff testified that he thought the first release was in order that he might be operated upon, the second release was a release for a new suit, and the third release [16] was a release for wages. The Court held it was a question of fact to determine whether the plaintiff knew or didn't know what he was signing, and, if he didn't know, the releases were void.

I have got a few other citations.

The Court: Well, let's proceed. I wanted to get your theories of counsel on either side.

Mr. Fernandez: Just one final point, your Honor: Counsel states that it is necessary to make a tender early in the game. Well, I don't think California law required that it be made too early. I think it can be made at the time of trial.

However, on the basis of our theory, and on the

basis of Meyer versus Haas and Raynale versus Yellow Cab Company, they state this, that in this particular situation where you are trying to say, "We thought this contract we are talking about was only for one small segment of our claim, it's not for all of our claim but for one small segment of it," in that particular type of factual situation it is not necessary to make a tender back because all you are saying is, "Well, sure, we settled for automobile collision damages, in other words, for our property damage, and so we thought we were making a contract and were getting back our \$100 for that, so it isn't necessary for us to retract."

Now, when I came into Court and made this statement earlier, I just wanted to point that fact out to you and then go on to say if counsel wants us to make a formal tender of what [17] he considers what the California law is, I will make it because I believe we can do it at any time.

The Court: Well, I don't think you can go on the basis that if counsel wants you to do something. I think you should do whatever you want to do yourself and then let's determine whether it is sufficient or not. But I don't think you can take the position that you will only do something if counsel wants you to do it.

Mr. Fernandez: No. I wanted to be sure I had that covered under all circumstances, your Honor.

The Court: All right.

Mr. Bruno: Your Honor, at this time we would like to call Oleta Story to the stand as an adverse witness under Rule 43B.

OLETA STORY

called as an adverse witness by the defendant under Rule 43B, being first duly sworn, was examined and testified as follows:

The Court: State your name, please.

The Witness: Oleta Story.

The Court: Keep your voice up so that we can all hear you, please.

Direct Examination

By Mr. Bruno:

Q. Where do you live, Mrs. Story, please?

A. 962 Moorpark, San Jose. [18]

Q. You are the plaintiff in this case, is that correct, Mrs. Story? A. Yes, I am.

Q. And you are married to Thurman B. Story?

A. Yes.

Q. And he was the owner of a vehicle which was being operated on October 2, 1955? A. Yes.

Q. You were a passenger in that car?

A. Yes.

Q. And it was involved in an accident, is that correct? A. Yes.

Q. On October 4, 1955, two days after this accident, Mrs. Story, did you not make a report through Brown Brothers Adjusters of San Jose to the American Insurance Company?

A. I called Raines Chevrolet where we bought the car, because we bought our insurance there from an agent, and reported the damage to the car.

Q. All right. And at that time you filled out an

(Testimony of Oleta Story.)

accident report for Mr. Raines and for your insurance company, is that correct? A. Yes.

Q. I will show you a document dated October 4, 1955, with signature, "Oleta Story," at the bottom, and ask you to examine the document and see if that is not the original report that [19] was turned in to your insurance company.

A. That is my signature, yes.

Q. And do you remember the report?

A. No, I don't remember.

Q. That is your signature?

A. That is my signature.

Q. All right. Do you recall reading or filling out that document on October 4, 1955?

A. No, I didn't fill it out.

Q. Who did you give the information to to fill out the document?

A. To Mr. Brown, I believe.

The Court: To who? I don't hear you.

The Witness: A Mr. Brown, I think, come to look at the car.

Mr. Bruno: We would like to offer this in evidence, your Honor.

The Court: Defendant's Exhibit A.

(Whereupon, the accident report above referred to was marked Defendant's Exhibit A in evidence.)

The Court: Do you recall where this was signed, Mrs. Story?

The Witness: I was at my sister's house. I

(Testimony of Oleta Story.)

brought the car from Marin County to my sister's house so they could look at it, and I was at my sister's house on Alberta Avenue in [20] Sunnyvale—or Cupertino, actually, is what her address was, between Sunnyvale and Cupertino.

The Court: Well, how did you happen to sign this? Who was there?

The Witness: There wasn't anyone there but just him.

The Court: Well, who?

The Witness: There wasn't anyone there but just this one man that looked at the car to see the extent of the damages to the car. I thought it was someone——

The Court (Interposing): Well, your husband—it starts out that the name of the insured is your husband, Thurman B. Story.

The Witness: Yes.

The Court: Was he there?

The Witness: No, he was working. He was in Marin County working.

The Court: You say this was some man from Brown Brothers?

The Witness: Well, I thought from my insurance company. Now, I don't know where he was from. I reported the accident to my insurance company.

The Court: And who was that?

The Witness: Well, I called Raines Chevrolet and talked to the agent there and reported my accident. They have [21] an agent there. We bought

(Testimony of Oleta Story.)

our insurance there at the time we bought our car.

Mr. Bruno: I think, your Honor, we can stipulate her insurance company would be the American Insurance Company.

Mr. Fernandez: That's right, I can stipulate to that.

The Court: All right.

Mr. Bruno: And that Brown Brothers Adjusters was handling the case for her insurance company, that is what I mean.

The Court: All right.

Mr. Fernandez: And what she remembers is a fellow named Brown.

Mr. Bruno: Yes. I say we will stipulate to that.

Mr. Fernandez: Yes.

The Court: All right, proceed.

Q. (By Mr. Bruno): Mrs. Story, at the time you completed this report, you had some pain in the neck area, is that correct?

A. Had a terrific headache, yes.

Q. You had a terrific headache and you also had pain in the neck?

A. And I was terrifically nervous.

Q. And you filled out this form on the back here where it says, "Personal Injuries," you said, "Whiplash"? [22]

A. No, I didn't.

Q. Well, you had somebody put down "whiplash"?

A. No, I didn't say anything about a whiplash.

Q. Who put that down there, then?

A. I don't know.

(Testimony of Oleta Story.)

Q. Was it there when you signed the document?

A. I told them that my neck popped and I had a terrific headache, but I didn't put anything down there. All I did was put my name.

Q. You read this document before you signed it?

A. No, I didn't.

Q. Well, nevertheless, the fact is your neck hurt, your head ached, and you knew that you had some injury on October 4, 1955, two days after the accident, is that correct?

A. Yes. On October 3, I couldn't get out of bed.

Q. October 3, you spent the entire day in bed? That is two days after the accident, is that correct?

A. That is right.

Q. And you were highly nervous the day after the accident, isn't that correct?

A. I was highly nervous the day of the accident, directly after the accident.

Q. And you had pain in the back of your head, right at the base of the skull, that ran into your neck and gave you a headache, too, isn't that correct? [23]

A. It come to the front of my head.

The Court: A little louder, please. I can't hear you.

The Witness: It come to the front of my head.

Q. (By Mr. Bruno): Now, ma'am, you never dealt, did you, with Jean I. Dobler or any agent or anyone claiming to be the agent or representative of Jean Dobler, is that correct?

A. That's correct.

(Testimony of Oleta Story.)

Q. The only one you ever dealt with in this transaction was your own insurance company?

A. That is what I was under the understanding, yes.

A. All right.

Mr. Bruno: I think I have the original here. You have seen this?

Mr. Fernandez: Yes.

Q. (By Mr. Bruno): I am going to show you a document entitled, "Release of All Claims," dated November 29, 1955, and signed "Therman Story and Oleta Story," and acknowledged by a Mr. Rutledge apparently as a notary public, and ask you if you recognize that document.

A. I recognize the signature.

Q. Is that your signature and that other signature that of your husband? A. Yes.

Mr. Bruno: I would like to offer this [24] general release into evidence, your Honor.

The Court: Defendant's Exhibit B.

(Whereupon, the general release was admitted into evidence as Defendant's Exhibit B.)

Q. (By Mr. Bruno): Mrs. Story, from whom did you receive this release?

A. You mean who mailed it to us?

Q. You received it in the mail, is that correct?

A. I received it in the mail.

Q. Did you get it from Mr. Raines, your insurance broker?

(Testimony of Oleta Story.)

Mr. Fernandez: I don't think Mr. Raines is an insurance broker.

The Witness: No.

The Court: You got it in the mail?

The Witness: We got it in the mail.

The Court: Was there a letter accompanying it?

The Witness: There was just a short note in it that we were to take it before a notary and sign it.

The Court: Was the note typed?

The Witness: Yes, it was typed.

The Court: And was there a signature to that?

The Witness: There was, but I don't remember the signature to it.

The Court: Do you know what happened to that note?

The Witness: No, I don't. I don't have it. [25]

Q. (By Mr. Bruno): By whom was the note signed? A. I don't know.

Q. Do you recall that it came from the Raines office or from the American Insurance Company?

A. It came from the Raines office.

The Court: From whose office?

The Witness: Raines Chevrolet.

The Court: How do you spell that?

The Witness: R-a-i-n-e-s, I believe.

Q. (By Mr. Bruno): That is Otis Raines, isn't that right? A. Yes, I think so.

Q. He is the man who sold you your insurance?

A. Well, they have an agent there that sold it to us. He didn't sell it to us direct, I don't believe, but we bought it at his place of business, yes.

(Testimony of Oleta Story.)

Q. When you bought the car, you bought the car and the insurance together? A. Yes.

Q. Now, you don't have that note you received from Mr. Raines' office, is that correct?

A. No, I don't.

Q. And all you recall it says is that you should read it and sign it before a notary public?

Mr. Fernandez: That isn't what she said. [26]

Mr. Bruno: This is cross-examination.

The Witness: No, I remember that it said to have it signed before a notary public.

Q. (By Mr. Bruno): What?

A. I remember that it said to have it signed before a notary.

Q. Now, Mrs. Story, you received that at home, is that correct? A. That is right.

Q. And nobody told you that it had to be back at a particular time, is that correct?

A. Well, I have the understanding——

Q. No, just answer the question.

Did anybody tell you it had to be back by a particular time?

A. Immediately, or by return mail, something like that.

Q. Did you have plenty of time to read the document?

A. I did, yes. I could have read it.

Q. And was Mr. Story at home at the time?

A. No, he was working.

Q. Did you sign the document before you took it to Mr. Story?

(Testimony of Oleta Story.)

A. No, I picked him up on the job. I went out on the job and picked him up and we went before a notary and signed it.

Q. The same day you received the document? [27]

A. I think so. I am not sure.

Q. And you went before Mr. Rutledge, and that would be on November 29th?

A. It was a woman.

Q. Her last names was Rutledge, apparently, is that correct? A. I suppose.

The Court: Where is she?

The Witness: In San Rafael. I don't know the exact street that she was on. We weren't too familiar with San Rafael.

The Court: Did you know her?

The Witness: No, I didn't know her.

Q. (By Mr. Bruno): And you also had a Mrs. Don Bowen and a Dorothy MacDonald witness your signatures, is that correct?

A. The next morning I asked them if they would sign it.

Q. And they were folks who lived there in the motel where you were staying?

A. Mrs. Bowen owned the motel.

Q. Mrs. Bowen owned the motel? And you signed this free from any duress? Nobody forced you to sign it?

A. No, I wasn't forced to sign it.

Q. Nobody tricked you into signing it?

A. Well, I don't know whether you would call

(Testimony of Oleta Story.)

it a trick or not. I didn't understand it. I thought I was signing it for my insurance company. [28]

Q. Well, now, ma'am, you read English, don't you? A. I do, yes.

Q. This isn't a very long document. Do you mean to tell the Court you didn't read this document? It's short, just two or three paragraphs.

A. No, I didn't read it.

Q. Will you read it and see if you can read it now and understand it?

(Witness reading document.)

Q. Have you read it? A. Yes.

Q. You understand it, don't you?

A. I understand it all right.

Q. As I understand, nobody forced you to sign the document?

A. No, no one forced me to sign it.

Q. And you had ample opportunity to read the document?

A. Well, I had an opportunity to read it, yes, but I was just trusting my insurance company.

The Court: You what?

The Witness: The conversation that I had on the phone. I had a conversation with a Mr. Brown on the phone, and he said they were sending the papers to us to sign and to take them before a notary and sign them, and to return them to them, and I was under the understanding that it was papers for them to collect their money for having

(Testimony of Oleta Story.)

our car fixed, and so I just [29] took the papers and signed them.

Mr. Bruno: I move to strike out that portion of the answer which contains her understanding as not being responsive.

The Court: Motion will be denied.

Q. (By Mr. Bruno): Now, no one was present there at the time you signed it?

A. No one but my husband and the notary.

Q. And you signed it freely and willingly, is that correct? A. That's right.

Q. Now, you received some money in the mail shortly thereafter, is that correct?

A. Not shortly after, no. It was several weeks after.

Q. In a matter of two weeks, I believe, you received some money in the mail?

A. I don't believe it was that soon. It could have been. I don't believe it was.

Q. Well, you tell us. I don't know.

A. I am not positive, but I think it was several weeks after before we received it.

The Court: Received what?

The Witness: We received our \$100 back that we paid on our hundred-dollar deductible policy.

The Court: Well, I don't understand that. \$100 back?

The Witness: One hundred dollars. Our policy was [30] a hundred dollar deductible policy. We had to pay that.

(Testimony of Oleta Story.)

The Court: Had you already paid that hundred dollars?

The Witness: Yes.

The Court: Before November 29th?

The Witness: Yes. We had to pay that to get our car fixed.

The Court: And who had you paid the hundred dollars to?

The Witness: Raines Chevrolet.

The Court: All right.

Q. (By Mr. Bruno): Then you received this \$100 back in the mail and the check was from your own insurance company, the American Insurance Company, is that correct? A. Yes.

Q. Before that, you received a check for \$330.80, isn't that correct, which they asked you to endorse and send back to them, do you remember that?

A. Yes, because they paid two hundred and some dollars for having the car fixed.

Q. Please answer the question first.

A. Yes.

Q. Isn't that true? A. Yes.

Q. In other words, about two or three weeks after you [31] signed this release, you received a check from Mrs. Dobler's insurance company?

A. No, it was mailed from our insurance company to us.

Q. But the check was that of Mrs. Dobler's insurance company, United Services Automobile Association, isn't that correct?

(Testimony of Oleta Story.)

A. I am not sure. Possibly it was.

Q. Nevertheless, the check was in the sum of \$330.80, is that correct?

A. I don't remember the exact sum.

Q. And you endorsed that check and signed it?

A. Yes.

Q. And you sent that back to your insurance company?

A. Yes.

Q. And then several weeks after that you received another check from your insurance company for \$100?

A. That's right.

The Court: Well, now, how much time was there between this first check for \$330.80 and the second check for \$100.00?

A. I don't know exactly.

The Court: Roughly?

The Witness: Two or three weeks, I would say.

Mr. Bruno: Your Honor, I can give it to you exactly.

The Court: A week or two? [32]

The Witness: Yes, at least.

Mr. Bruno: Would your Honor be interested in the exact dates on that?

The Court: No, no, I just wanted to get the approximate time.

Mr. Bruno: I have a copy I can show to counsel, and I think we can stipulate as to the date she received the \$100 check from the American Insurance Company. I have a duplicate copy of that check.

January 30, 1956, a check was made out by the

(Testimony of Oleta Story.)

American Insurance Company in the sum of \$100 to Thurman B. Story and Oleta Story.

I can get your Honor the other date, too. The check in the amount of \$330.80 was made out on January 12, 1956, to Thurman B. Story and Oleta Story, husband and wife, and American Insurance Company.

Q. (By Mr. Bruno): You repaid that \$100 and cashed that check? A. That's right.

Q. And you have never offered that hundred dollars back to Mrs. Dobler?

A. Yes, it was offered back.

Q. When? A. Before I instituted——

The Court: I don't hear you, Madam. [33]

The Witness: It was offered back when I called this case.

Q. (By Mr. Bruno): To whom?

A. My attorneys offered it back, if I am not mistaken, to her insurance company or to her, I don't know.

Q. Were you present when that offer was made?

A. No, I was not present when the offer was made.

Q. Did you ever see a letter of that type?

A. Yes.

Q. To whom was the letter written?

A. I signed the paper to that effect.

The Court: A little louder, please.

The Witness: I have signed papers to that effect.

(Testimony of Oleta Story.)

Mr. Bruno: Counsel, can you show me a copy of such a document? I have no such document.

Mr. Fernandez: It might be possible that Joe has it—Mr. Lewis, who got the case initially. I believe that whatever was done might have been done orally.

Mr. Bruno: The witness is speaking of a written document, a rescission, apparently. I would like to see it because I have never seen any such document.

Mr. Fernandez: I know you wrote us a letter asking information.

The Court: Counsel, I can't hear all of you having a private conversation. If it is to be of any value to me, [34] I would like to hear it.

Mr. Fernandez: Your Honor, this was handled initially by Mr. Joseph Lewis, and I remember Mr. Bruno wrote us a letter concerning this release, and I believe, whether mistakenly or not, that Mr. Lewis had a conference with you or with Mr. Bruno's insurance company regarding the return of the \$100, but I don't have any note of it in my file concerning the fact that there was any signed statement or any notation that we had sent official offer to return the amount.

Q. (By Mr. Bruno): Mrs. Story, the only thing you ever signed for Mr. Lewis was the complaint starting this law suit, isn't that correct?

A. No, I have signed some more documents. My statements that I gave him.

Q. You never signed any document whatsoever

(Testimony of Oleta Story.)

offering back or tendering back a hundred dollars to me, to the insurance company, or to Jean Dobler, isn't that correct?

A. Yes, I have signed such a statement. There is a statement in my files that I have signed it where I offered a hundred dollars back.

Q. You mean it was in a written document?

A. Yes.

Mr. Bruno: I can state to the Court as an officer of the Court that I have no knowledge of any such document, and I challenge counsel to produce a copy of it. [35]

Mr. Fernandez: You can challenge me, but I don't have it.

Mr. Bruno: You have the whole file there, don't you?

Mr. Fernandez: I do, yes, but—(remainder of statement inaudible to the reporter).

Q. (By Mr. Bruno): Did you ever put the hundred dollars into your attorney's office?

A. No. My attorney was handling it for me and I signed the paper. He showed me the paper and I signed it.

Q. Well, did you ever produce the hundred dollars? Did you ever have a hundred dollars ready for the return?

A. He never asked me for it.

Q. It is true, Mrs. Story, that no one from my office and no one from the United Services Automobile Association, any representative of Mrs. Dobler, Mrs. Dobler herself, or any agent of Mrs. Dobler,

(Testimony of Oleta Story.)

ever communicated with you, talked with you, concerning this subject? A. No.

Q. Concerning a settlement? A. No.

Mr. Bruno: Thank you. I have no further questions.

Mr. Fernandez: I have some questions, your Honor. [36]

Cross-Examination

By Mr. Fernandez:

Q. Mrs. Story, do you know approximately how much were the automobile repairs on this car that was damaged?

A. Three hundred and some dollars. The amount of the check that he mentioned.

Q. Now, to what grade did you get in school, Mrs. Story? A. To the eighth grade.

Q. Now, at or around the time when you signed this agreement—let's put it this way:

Between the time of the accident and the time that you signed the agreement, did you have the advice of any attorney? A. No.

Q. When you signed this agreement, what was your understanding concerning it?

Mr. Bruno: Objected to, your Honor, upon the ground that it calls for evidence attempting to vary the terms of the written document.

Mr. Fernandez: We are trying to show that the document isn't what it purports to be, that there was a mistake of fact. We are trying to show what

(Testimony of Oleta Story.)

this contract actually is and what the parties understood it was.

The Court: I think you might be entitled to show events that occurred prior to the time of the signing of the document. [37]

Mr. Fernandez: All right.

The Court: Let's see what those are.

Q. (By Mr. Fernandez): Now, you had two conversations with a person from your insurance company? I believe his name was Mr. Brown, is that correct? A. Yes.

Q. Now, at the time you first talked to this person that we will call Mr. Brown, that was at the home of your sister in Sunnyvale, was it?

A. Yes, when he looked at the car.

Q. And you had already called up the Raines Chevrolet people and told them about the accident?

A. Yes.

Q. How many days after the accident was it that you first talked to Mr. Brown?

A. The second day after the accident.

Q. Did you know that he was from the American Insurance Company, your insurance company?

A. No, I didn't know actually. I assumed he was because he was sent out to look at the car.

Q. Now, what did he tell you concerning how much you would have to pay to repair your automobile?

A. He said we would have to pay a hundred dollars.

(Testimony of Oleta Story.)

Mr. Bruno: I object to that on the ground it calls for hearsay testimony, your Honor. [38]

The Court: No. It may be a type of hearsay, but in order to establish her state of mind, I think she is now testifying what would be told to her.

Mr. Bruno: As I understand the ruling, your Honor is allowing the testimony merely to show her state of mind rather than for the truth of the matter?

The Court: That's all.

Mr. Fernandez: Could you repeat the question, please?

(Question and answer read by the reporter.)

Q. (By Mr. Fernandez): What kind of policy of insurance did you have concerning collision repairs to your car? Was it a one hundred dollar deductible policy? A. Yes.

The Court: Now, those things are generally understood, but I think you should spell it out as to what that means, counsel.

Q. (Mr. Fernandez): In other words, Mrs. Story, your insurance covered repairs to your car only for damages over and above a hundred dollars?

A. That's right.

Q. And you had to pay yourself the first hundred dollars? A. Yes.

Q. Now, did you say anything to him when he told you you had to pay this hundred dollars to have your car fixed?

A. Well, I told him that I didn't understand

(Testimony of Oleta Story.)

why we had [39] to pay a hundred dollars when she run into us, and he said, well, her insurance company was an out-of-state insurance company.

The Court: Her what?

The Witness: Her insurance company was an out-of-state insurance company.

Mr. Bruno: Your Honor, I move to strike the last question and the last answer on the further ground that, first of all, it does call for hearsay evidence and your Honor has ruled on that, but I want to object on the further ground that even if it tended to prove the state of mind of the witness at the time she signed this document, this would be an immaterial piece of evidence on the ground that it just tends to show a unilateral state of fact, which it is clear in the law is not an excuse for rescission of a contract or for voidance of the release.

The Court: Overruled.

Mr. Fernandez: Where were we? What was my last question before that objection, please?

(Question and answer read by the reporter.)

Q. (By Mr. Fernandez): Does that complete your answer? A. Yes.

Q. Now, did you have another talk with Mr. Brown again, or this person you believed to be Mr. Brown? A. Yes. [40]

Q. This was a telephone conversation?

A. Yes.

(Testimony of Oleta Story.)

Q. Did you ask him or did he tell you about some papers he was going to send you?

A. Yes.

Q. What did he tell you concerning the papers?

A. Well, he said that——

Mr. Bruno (Interposing): Let the record show the same objection.

The Court: Same ruling.

Q. (By Mr. Fernandez): Go ahead.

A. He said that he was sending us these papers to sign and for us to sign them and send them back to them so that they could receive their money from her insurance company.

Q. What did you say when he told you this concerning what you were signing, the papers he was sending you? A. Well, I thought——

Mr. Bruno: Objection.

The Witness: I thought it was so they could collect what they had been out——

Mr. Bruno (Interposing): Mrs. Story, please.

Your Honor, I think that is completely incompetent, irrelevant and immaterial, what she thought, because the theory of meeting of minds under contract was drawn out years ago. It is what is definitely stated in the written word that counts. [41]

The Court: Well, we haven't gotten to that yet, have we?

Mr. Bruno: Well, what she thinks I think would be irrelevant, or what she thought.

The Court: Overruled.

(Testimony of Oleta Story.)

Mr. Fernandez: Will you repeat the last question that was answered?

The Court: I think, counsel, if you will go into this telephone conversation a little more in detail, please, that she had with this Mr. Brown, the second conversation?

Mr. Fernandez: Okay.

Q. Now, where were you when you had this telephone conversation with Mr. Brown?

A. Marin Motel.

The Court: At where?

A. At the Marin Motel.

The Court: Marin Motel? A. Yes.

The Court: Was that your permanent place of residence?

A. That is where we were living at the time, yes. My husband was working on a job in Marin County.

The Court: Working where?

A. He was working on a job in Marin County at that time and we were staying at the Marin Motel. [42]

The Court: How long had you been there?

The Witness: We had been there since September, some time in September.

The Court: Of 1955?

The Witness: Yes.

The Court: And what type of employment was your husband on at that time?

The Witness: My husband is an operating engineer. He operates heavy equipment.

The Court: Was this some construction job?

(Testimony of Oleta Story.)

The Witness: Yes, a construction job.

The Court: Near where you were staying?

The Witness: Yes. Saint Vincent School.

The Court: What?

The Witness: It was at Saint Vincent's School.

Q. (By Mr. Fernandez): Did you call Mr. Brown, or did he call you? A. He called me.

Q. Do you recall what the conversation was between you and Mr. Brown concerning repairs to your automobile?

A. No. I remember that he said he was sending us the papers to sign so that they could get their money back that they had been out on our car from her insurance company.

Q. Did he tell you anything about your physical trouble? A. No. [43]

Q. Did he tell you about any medical bills or doctor bills you might incur? A. No.

Q. Or that you had incurred? A. No.

Q. Did he tell you at that time if you signed the papers you would get your hundred dollar deductible back? A. No.

The Court: There was nothing said about your getting this \$100 back in that conversation?

The Witness: No. The only way they ever said that we would get our hundred dollars back was if her insurance company paid all of the damages on the car that we would receive our hundred dollars deductible back, otherwise we wouldn't.

The Court: When was this said to you?

The Witness: Well, they told us that from the

(Testimony of Oleta Story.)

very beginning. When they first looked at the car they told us that.

Q. (By Mr. Fernandez): Now, just to go back for one moment, you bought your car from Raines Chevrolet, is that correct, in Sunnyvale?

A. Yes.

Q. And you also got your insurance from Raines Chevrolet? A. Yes.

Q. And in your dealings with him, your initial dealings on this accident was with Raines Chevrolet Company, is that right, [44] or with the insurance agent of the American Insurance Company?

A. Well, I reported it to the agent at Raines Chevrolet.

Q. Now, when later on, after you had this second conversation with Mr. Brown, you said you received a letter in an envelope in the mail containing the releases that we have here, is that correct?

A. Yes.

Q. Now, what was the return address on the envelope?

A. It was in a Raines Chevrolet envelope.

Q. And after you signed the release, or after you signed the papers that were in that envelope—may I rephrase that question?

After you had signed the paper that was in that envelope, who did you send it back to?

A. Raines Chevrolet.

Q. When you signed the paper on November 29, 1955, what did you think you were signing?

A. I thought it was what Mr. Brown said I was

(Testimony of Oleta Story.)

signing, just for them to get their money back from the other insurance company that they had been out on our car.

Q. And it was the day after you received it that you mailed it back to whom?

A. Raines Chevrolet.

Q. Later on in the mail you got a letter with a check addressed to Thurman Story and Oleta Story and the American [45] Insurance Company, is that correct?

A. Yes, it was mailed from our insurance company.

The Court: What is that? I don't think that question was clear, counsel.

Mr. Fernandez: Well, strike the question. I will repeat it.

Q. After you signed the papers you received a check in the mail, is that correct? A. Yes.

The Court: Didn't it have a letter with it?

The Witness: I don't recall.

The Court: Well, how would you know to send it back if it didn't have a letter with it?

The Witness: You mean the check back?

The Court: Yes.

The Witness: Yes, the check said just to endorse it and send it back. It was made out to my husband and to me and to the American Insurance Company.

The Court: Well, was there a letter with it?

The Witness: Yes, for us to endorse it and give it back.

(Testimony of Oleta Story.)

The Court: Do you have that letter?

The Witness: No, I don't have.

Q. (By Mr. Fernandez): Then you endorsed it and sent it back to whom? [46]

A. To our insurance company, I think.

Q. Then a week or two after that you got a check in the mail, is that correct?

A. Something like that. It was quite a while afterward.

Q. And what was the amount of that check?

A. \$100.

Q. Had you paid the hundred dollars to Raines Chevrolet to repair your car? A. Yes.

Q. Are you still having trouble in your neck?

Mr. Bruno: Objected to on the ground it is irrelevant.

The Court: Well, counsel——

Mr. Fernandez: I am not going into the details on it.

The Court: I think you should. In other words, both of you have cited a number of authorities here. We are not going to do this in two bites. I take it that I will have an opportunity to read the authorities after the matter is over, but I think you should go—If you are finished with your proof about the release now, if you then desire to go into the personal situation, which would be only important if the release issue is determined in your favor.

Mr. Fernandez: Yes.

The Court: If it isn't determined in your [47]

(Testimony of Oleta Story.)

favor, why, it will not be of any importance; but we will do it all at one time and then the Court will have an opportunity to look at these authorities and digest them.

Mr. Bruno: In that respect, your Honor, I am sure what your Honor says is a desirable thing, but that is not what I had in mind when I objected to——

The Court (Interposing): Well, what are we going to do—two trials?

Mr. Bruno: The only difficulty I have is, I have never received a notice of time of trial in this case at all. I never knew the case was on the calendar until Mr. Fernandez and my associate happened to be in court here a week or two ago when the case was called. I don't think Mr. Fernandez knew about it, either. Since they didn't know about it, the case was continued until today.

Then I got busy and I found out in the last two days that Mrs. Dobler, or Miss Dobler, is an Army nurse, was transferred from Hamilton Air Field to Germany. I have no deposition from her. I have never talked to the lady.

And so I want to point that out to the Court. I am at a serious disadvantage in that respect, and at least I would like to consult with her or communicate with her as to her wishes in the matter before I proceed on the question of liability. That is why I thought we could try only the question of the release and see if the rest could be obviated. If [48]

(Testimony of Oleta Story.)

your Honor rules against us in that respect, why, in the meantime, of course, I can communicate with her and be ready in a week or two.

The Court: I think we ought to complete the testimony of this witness upon all issues at this time, and if you then desire to have a continuance for the purpose of producing such testimony on the question of liability as you desire, we will arrange for such a continuance.

Mr. Bruno: All right, your Honor.

The Court: And we will put it over to some other time, but let's finish all the issues with this witness at this time.

Mr. Fernandez: For the record, I might also point out that it was partly through our ignorance of Federal procedure, which might have hurt Mr. Bruno in this respect. Of course, Mr. Gassett and I were in Court on the 23rd and had this matter put over until today. No, I think it was sooner than that. Probably the 18th.

The Court: Well, isn't there a Notice of Motion to set? Wasn't that served on counsel?

Mr. Bruno: Yes, that was received, but we never received any notice of time of trial at all, which is required by the rules, and I just waited patiently knowing it would be set, and I assumed they would tell us when the trial was going to be, but we just happened to be in Court on a criminal matter [49] on the 18th and found out this was set.

That is Rule 14, your Honor—excuse me, Rule 17 of the Rules of the Court.

(Testimony of Oleta Story.)

The Court: It is not in the General Rules.

Mr. Bruno: No, it is Rule 17 of the Northern District. Notice of Time of Trial will be served when the other party wasn't present at the time of setting, which we weren't.

Mr. Fernandez: Of course, you were present at the time of resetting.

The Court: Was anybody present at the time of the setting of this case for trial?

Mr. Bruno: No, we were not.

Mr. Fernandez: Our office was, yes, but the other party wasn't. They were present, however, on the 18th when it was reset over for today. I explained to Judge Harris it was due to our ignorance of the procedure.

The Court: It was originally set for December 18th for trial, is that right?

Mr. Fernandez: The 19th, and on the 18th I was in Court and Mr. Gassett was also in Court at that time, and we requested that the matter be put over until today.

Mr. Bruno: We were in Court on other matters. We just happened to be here.

Mr. Fernandez: I was here on this matter.

Mr. Bruno: But we were not. [50]

The Court: Somebody from your office was here, and on that day received information that it would be tried upon the 30th of December, is that right?

Mr. Bruno: That's right. That is when I got busy.

The Court: All right.

(Testimony of Oleta Story.)

Mr. Fernandez: Well, it is my understanding that we are going to cover the whole witness?

The Court: Yes.

Q. (By Mr. Fernandez): Mrs. Story, what was your occupation at the time of the accident?

A. Housewife.

Q. And how long have you been so employed?

A. How long?

Q. Yes. A. 16 years.

Q. Now, you were married to Mr. Thurman Story, the gentleman over to my left?

A. Yes.

Q. And where were you living at or about the time of this accident?

A. At the Marin Motel.

Q. This was in Marin County? A. Yes.

Q. Now, directing your attention to October 2, 1955, Mrs. Story, were you living at the Marin Motel at that particular [51] time? A. Yes.

Q. Did you and your husband have occasion to leave the Marin Motel for San Francisco on that day? A. Yes.

Q. And what highway were you going to take to get to San Francisco? A. 101.

Q. You were heading for San Francisco?

A. Yes.

Q. And you got onto 101 and drove in which direction? A. South.

Q. Just so that we understand it, Highway 101 generally runs north and south— A. Yes.

Q. —near the vicinity of this accident?

(Testimony of Oleta Story.)

A. Yes.

The Court: May I interrupt you, Mr. Fernandez? The reporter has been going pretty steadily. We will take a short recess.

(Short recess.)

Q. (By Mr. Fernandez): Mrs. Story, where did you go to school? Was it in Oklahoma?

A. In Oklahoma.

Q. When did you come to California for the first time? [52]

A. To live?

Q. Yes. A. In August, 1954.

Q. Where had you lived before that time?

A. In Oklahoma.

Mr. Bruno: That I think is incompetent, irrelevant and immaterial.

The Court: Oh, I think it is shown there now. Let's go on.

Q. (By Mr. Fernandez): Now, we have come to the accident that happened on November 2, 1955.

A. Yes.

Q. Do you recall it happened at the intersection—at the Greenbrae intersection in Marin County?

A. Yes.

Q. That is the intersection of Highway 101 and Sir Francis Drake Street, is that correct?

A. I guess. All I know is that they call it the Greenbrae intersection.

Q. In other words, Highway 101 crosses the street at that point?

A. Yes.

Q. So we understand what we are talking about.

(Testimony of Oleta Story.)

the highway at and near this intersection, Highway 101, runs north and south? A. Yes. [53]

Q. And you were going where?

A. To San Francisco.

Q. And as you came up this—strike that.

Who were you going with on this particular day?

A. With my husband, and we had two little boys visiting us and we were taking them to the zoo.

Q. Where were you sitting?

A. On the right-hand side in the front.

Q. And your husband, was he driving?

A. Yes.

Q. And the two little boys, where were they?

A. One was between us on the front seat, and the other was in the back seat.

Q. What kind of vehicle were you driving on this day? A. 1955 Chevrolet.

The Court: You were driving a 1955 Chevrolet?

The Witness: My husband was driving a 1955 Chevrolet.

Mr. Fernandez: My question was erroneous.

Q. Who owned that particular vehicle?

A. My husband and I.

Q. And as you came up to this Greenbrae intersection, did you notice whether there was any traffic signal there? A. Yes.

Q. What kind of signals? Stop lights, a sign, or what? A. A light. [54]

Q. As you approached the intersection, say about 300 feet away, do you remember what the

(Testimony of Oleta Story.)

color of the lights were for traffic going southbound on 101?

A. The light turned red, and we stopped.

Q. You stopped where, before the intersection, at the intersection, in the intersection, or where?

A. We were the first car. We were stopped right where you normally stop at a intersection.

Q. Can you describe your stop? Was it sudden, slow, gradual, or what?

A. I would say just about an average stop.

Q. Were there any cars in front of you?

A. Yes.

Q. Were there any cars stopped to your right at the time you came to this stop?

A. Not when we come to the stop, but I think there was one pulled up to the side of us.

Q. What was the color of the light when you came to a stop? A. Red.

Q. While you were in this position of rest, was your vehicle struck by another car from the rear?

A. Yes.

Q. How long had you been in this position of rest before you were struck?

A. Well, I don't know just how long. A few seconds, though, [55] at least.

The Court: How long?

A. At least a few seconds. I don't know just how long. It could have been a minute, or it could have been less. I don't know just how long it was.

The Court: What do you mean by "a few seconds"? How many seconds is that?

(Testimony of Oleta Story.)

The Witness: Oh, I would say at least 15 to 30 seconds. I don't know, actually. I know that we were at a full stop and was sitting there waiting on the light before she run into the back end of us.

Q. (By Mr. Fernandez): Now, you were in the middle lane, is that correct? A. Yes.

Q. How many lanes were southbound lanes on 101? A. Two, I think, aren't there?

Q. Did you ever see this vehicle that struck you from the rear? A. No.

Q. I should rephrase the question: Did you see it any time before the accident? A. No.

Q. What was your first knowledge that an accident was going to happen? What was the first thing?

A. We didn't have any knowledge of it at all until it [56] happened.

Q. You mean you just felt the impact?

A. That's right.

Q. Was your car pushed any distance as a result of the impact? A. Yes.

Q. Was it pushed forward, to the side?

A. Forward.

Q. How far was it pushed, do you know?

A. Completely across the intersection and on down the highway away.

Q. Do you know how wide the highway is at this point? A. No, I don't.

Q. Would you say it was more than 40 feet, or less than 40 feet?

A. I really don't know.

(Testimony of Oleta Story.)

Mr. Bruno: That is leading and suggestive. She said she didn't know.

The Court: Yes, she says she doesn't know.

Q. (By Mr. Fernandez): What happened to your body immediately after the impact?

A. What happened to my body?

Q. Yes.

A. Well, I went forward. It tore our front feet loose and threw us forward. [57]

Q. Did any part of your body strike any part of the car?

A. The front of my forehead hit the windshield.

Q. Did you feel anything in your body right after the impact insofar as pain or unusual sensation?

A. Yes. There was hurting right at the base of my skull. My neck popped and was hurting right at the base of my skull.

The Court: What?

The Witness: Right at the base of my skull here.

The Court: Well, what happened? You haven't told me that.

The Witness: My neck popped and I had a hurting there.

Q. (By Mr. Fernandez): Was your head pushed forward at all as a result of this impact?

A. Yes.

Q. What happened after your head hit the windshield? A. I went back.

Q. You told us about your neck popping. Was

(Testimony of Oleta Story.)

there anything else in any other part of your body that popped or that you felt some unusual sensation? A. Nothing that I felt at the time.

Q. After you were pushed across the intersection and got out of the car, did you have a conversation with the driver of the other vehicle?

A. No, I didn't. [58]

Q. Did you see the other people?

A. Yes, I saw them.

Q. Did you notice the damage to the—strike that.

Did you see the other car that hit you?

A. Yes, I saw it.

Q. Where was the other car after you had gotten out of your vehicle? Where was it sitting?

A. I really couldn't tell you how far behind our car. It was behind our car, but I don't know just the distance.

Q. Was it in the intersection, to the south of the intersection, or to the north of the intersection? Or just where in general?

A. I don't remember just where it was.

Q. Did you see what the damage was to this other vehicle at the time you got out of your car?

A. Not completely. I did notice that the front——

The Court: Please keep your voice up.

The Witness: I did notice that the front end of the car was smashed in quite a lot.

Q. (By Mr. Fernandez): Was it generally in the front end, though? A. Yes.

(Testimony of Oleta Story.)

Q. Did you notice where the damage was to your car?

A. It was to the back end of our car.

Q. What about the seats? Did it disturb the seats? [59]

A. Yes, they were torn completely loose and the steering wheel was broken in two places.

Q. Was there any other damage to the car?

A. The controls on the heater, the heater control was all bent.

Q. Was there any damage to the front end of the car? A. No, no damage to the front end.

Q. Was there any damage to the windshield that you saw? A. No.

Q. After you got out of your car, did you feel any unusual sensation in any part of your body?

A. Just that hurting at the base of my skull, and my head started hurting, and I was extremely nervous.

Q. What did you do after the accident? Did you go home or go on to San Francisco?

A. We went on to San Francisco, but we didn't even go into the zoo. We turned around and——

The Court: You what?

The Witness: We didn't even go into the zoo. We turned around and went home because I was feeling so bad and so nervous.

Q. (By Mr. Fernandez): You were going to the zoo in San Francisco, I take it? A. Yes.

Q. Why did you go home, now? [60]

A. I was feeling bad. I had such a headache and

(Testimony of Oleta Story.)

I was nervous, so we turned around and went home.

Q. Did you see a doctor—strike that.

When was the first time you saw a doctor for your troubles?

A. I believe the first time that I went to a doctor was in September of 1956. I saw a doctor in December, on Christmas Day, for a headache at the San Rafael Hospital.

The Court: For what?

The Witness: For a headache.

The Court: You saw a doctor in December of 1955?

The Witness: Oh, 1955, yes.

The Court: For a headache, you say?

The Witness: Yes.

The Court: Up to that time you hadn't seen any doctor at all?

The Witness: No.

The Court: Well, between the date of the accident, October 2nd, up till Christmas, what had been your condition at that time?

The Witness: Well, it would come and go. I would have severe headaches, and then they would go away.

The Court: At any time, were you confined to your bed by reason of this accident?

The Witness: With severe headaches I have been off [61] and on, yes.

The Court: Well, I am speaking of the time between October and December. Were you confined to your bed the next day after the accident?

(Testimony of Oleta Story.)

The Witness: Yes, all day.

The Court: What?

The Witness: All day the next day after the accident.

The Court: Why were you in bed then?

The Witness: Well, I was sore all over, couldn't hardly——

The Court: And you stayed in bed that one day?

The Witness: Yes.

The Court: Thereafter, were you confined to your bed at any time by reason of the accident?

The Witness: Only when I had severe headaches.

The Court: And where were these headaches?

The Witness: They start in my neck and go to the front of my head.

The Court: But you didn't go to see a doctor about this condition?

The Witness: No. The first time I saw a doctor was December 25th.

Q. (By Mr. Fernandez): 1955?

A. Yes. [62]

The Court: Where did you see a doctor then? At his office?

The Witness: At the hospital at San Rafael.

The Court: How did you happen to go there on that day?

The Witness: My husband took me. I had such a severe headache, my husband took me.

The Court: Did you get any treatment there at that time?

(Testimony of Oleta Story.)

The Witness: Yes, he gave me a shot and gave me some kind of a tablet to take for my head.

The Court: He gave you a shot where?

The Witness: In my arm.

The Court: Well, what was that for? For pain?

The Witness: For pain.

The Court: And you got some tablets? What were they?

The Witness: For pain.

The Court: Like aspirin, or——

The Witness: No, they were prescriptive.

The Court: Codeine? You don't know what?

The Witness: I don't know what it was.

The Court: All right, did you go to a doctor at any time after December 25, 1955?

The Witness: Not until—I think it was in August [63] or September. I believe it was in September of 1956, that I went.

The Court: September, 1956?

The Witness: Yes.

The Court: How did you happen to go to the doctor at that time?

The Witness: Well, I had been having pain all the time, and it was getting worse, and it had gone down into my right arm and I was losing the use of my right arm, and my sister kept on at me to go to the doctor and I finally went.

The Court: What doctor was that?

The Witness: Dr. Besson at Sunnyvale.

The Court: Were you living there in Sunnyvale at that time?

(Testimony of Oleta Story.)

The Witness: Yes.

The Court: After the accident, how long did you live at the Marin Motel before you moved away?

The Witness: It was the last part of January or first part of February that we went back to Sunnyvale.

The Court: All right. Now, when you saw this doctor in September, 1956, did you get any treatment at that time?

The Witness: Yes.

The Court: What?

The Witness: He gave me some kind of heat treatments. [64]

The Court: Heat treatments?

The Witness: Yes, with a lamp and what he called deep sound treatments.

The Court: Directed to what portion of your body?

The Witness: To my arm and shoulder here. The right arm and shoulder.

The Court: What kind of a doctor was this man?

The Witness: He is just a medical doctor.

The Court: A general practitioner? He wasn't a specialist?

The Witness: No, he wasn't a specialist.

The Court: And how did you get this treatment, at his office or at your home?

The Witness: At his office.

The Court: How many treatments did you get?

The Witness: Well, I don't know for sure. I think I taken five or six treatments from him off and on. He wanted me to take treatments every day

(Testimony of Oleta Story.)

but I couldn't get in every day to take treatments.

The Court: All right, go ahead, counsel.

Q. (By Mr. Fernandez): Now, between October 2, 1955, and December 25, 1955, where was your trouble in your body?

A. In my neck and head.

Q. Were there any other parts of your body bothering you?

A. Between December and October? [65]

Q. Between October 2, 1955, to December.

A. No.

Q. Now, this trouble you had in your neck and head, was it always with you, or was it just with you part of the time?

A. No, it would just come and go part of the time.

Q. Do you know how often it would come during a month between those two periods I mentioned?

A. Oh, I would say every week or at least ten days.

Q. And when you had this headache and the trouble in your head and neck, what did you do?

A. Well, I would go to bed and stay in bed, and I would take aspirin or D.C. powders, anything that I thought might relieve it.

Q. And between Christmas of 1955 and up to September of 1956 did you have any other trouble in any other parts of your body other than those you have just mentioned?

A. Yes, it went down into my shoulder and arm.

Q. Which shoulder are you referring to?

A. The right shoulder.

(Testimony of Oleta Story.)

Q. Can you indicate to the Court the direction that this trouble took?

A. It goes down into my neck and into my right shoulder and upper part of my right arm.

Q. And was this pain constant or just part of the time? A. Yes, it was constant. [66]

Q. Can you describe this trouble that went into your right arm?

A. Well, I really don't know how to describe it. You mean the pain?

Q. Yes.

A. It hurts just like my neck does, but it is in my arm. The same pain as the neck. It is sore and—I can't describe the pain. It is a kind of a sharp pain, especially when I move my arm or if I move my neck it is a sharp pain.

Q. Between Christmas, 1955, until December, 1956, did this pain in your arm and shoulder get better, stay the same, or get worse?

A. It got worse.

Q. What about the trouble in your neck and your headaches, did that get better, stay the same, or get worse? A. It's gotten worse, too.

Q. This pain in your right arm, did it have any effect upon your ability to grip? A. Yes.

Q. What effect did it have?

A. Well, I couldn't hold on to things. I couldn't grip things like I could before.

Q. What about your ability to lift?

A. No, I couldn't lift anything. It hurt.

The Court: What? [67]

(Testimony of Oleta Story.)

The Witness: It hurt my arm to lift anything.

Q. (By Mr. Fernandez): How about your housework during this period? Could you do all your normal activities? A. No.

Q. What are some of the things you couldn't do?

A. Well, I can't do my sweeping or mopping, I can't do my washing or ironing.

Q. This is true also today, is it? A. Yes.

The Court: Well, you do some of that, don't you?

The Witness: No, I don't.

The Court: What?

The Witness: No, I don't. I happen to have some good friends and some sisters-in-law, and neighbors, that is good to me and helps me out or I wouldn't have anything done. I can't do my ironing nor my washing.

The Court: Do you mean by that that you don't do any of them at all, or that when you do it causes you some pain and you are not able to continue?

The Witness: Well, I just don't do it because I haven't been able to and I know that it causes pain and makes it worse, so I just don't do it.

Q. (By Mr. Fernandez): After September of 1956, did you see anybody else for your troubles?

A. After what? [68]

Q. After September of 1956—wait a minute. Just strike the question.

Who did you see? What was the name of the doctor you saw in September, 1956?

A. Dr. Besson, in Sunnyvale.

(Testimony of Oleta Story.)

Q. After you saw Dr. Besson, did you see any other doctors?

A. I did see a Dr. Goddard in October of this year.

Q. Where is Dr. Goddard's office, do you know?

The Court: How do you spell that?

The Witness: G-o-d-d-a-r-d, I think.

Q. (By Mr. Fernandez): How did you happen to see Dr. Goddard?

A. Actually, my husband called Dr. Zarka because his office was close to where we lived. I couldn't move. He had to raise my neck up. I couldn't even raise my head up. I woke up that way. He called Dr. Zarka and Dr. Zarka wanted him to bring me to the hospital, and he took me over there and Dr. Zarka turned me over to Dr. Goddard.

Q. Can you tell us a little bit about this being unable to move situation?

A. Well, I just couldn't raise my head up, it was so painful to move. Dr. Goddard said it was muscle spasm.

Q. Had you ever had this trouble before?

A. Well, yes, but not that bad.

Q. Was it your whole body? [69]

A. No, just the upper part of my body.

Q. Now, you say you went to O'Connor's Hospital?

A. Yes.

Q. That is in San Jose, also?

A. Yes.

Q. How long were you in O'Connor's?

A. Just for X-rays. They didn't enter me. I was

(Testimony of Oleta Story.)

an outpatient. They just—well, he examined me and had X-rays taken.

Q. Where did you go after that? Back home?

A. Back home.

Q. Now, did you get any treatment from Dr. Goddard? A. Yes.

Q. What was that treatment?

A. He gave me medicine and he sent me to some physiotherapist and they give me oscillating traction.

The Court: Oscillating what?

The Witness: Oscillating traction and heat treatments and deep sound treatments.

Q. (By Mr. Fernandez): What is the name of these people who gave you this traction and deep sound treatment? A. Sherman and Horn.

Q. Were they physiotherapists? A. Yes.

Q. Where are they located? [70]

A. In San Jose.

Q. How long have you had treatments from them?

A. Well, since October. I was supposed to take a treatment every day, but I haven't been able to take them every day. I have taken several treatments from them. I don't know just how many.

Q. Where did they give you this treatment, what parts of your body?

A. Across my shoulders and back.

Q. Now, directing your attention to this general period of time of December and November, can you tell us, describe to us, what is the condition of your

(Testimony of Oleta Story.)

neck at the present time with reference to your trouble?

A. Well, it is still sore and hurts to move it.

The Court: What?

The Witness: It's still sore and hurts to turn it.

Q. (By Mr. Fernandez): Can you tell us what happens when you move your neck to the left or right?

A. It hurts to move it.

Q. Do you notice that you can't move your neck all the way that you could before the accident?

A. Yes, I can't move it as far.

Q. Now, what about movements up and down?

A. It hurts either way.

Q. Can you just show us where it hurts when it hurts? [71]

A. You mean turn my head to where it hurts?

Q. Just indicate for the record.

A. Well, it hurts right back at the base of my neck and down my shoulders.

Q. Do you have any trouble up on the top?

A. Only when I have severe headaches.

Q. That would be the base of the skull I was pointing to?

A. Yes.

Q. Do you still have these headaches?

A. Yes.

Q. And where are they usually?

A. They go from my neck back there and up to the front of my head.

Q. Now, how often do you get these headaches during a month? Say in the last two months, how often have you had them?

(Testimony of Oleta Story.)

A. Well, I have headaches nearly every day. As far as headaches, I am hardly ever without a headache; but those severe headaches, I have three or four of them a month.

Q. How often do you get pain in your neck?

A. I have pain in my neck all the time when I move it.

Q. Are you trying to say you are never free from pain in your neck at the present time?

A. That's right. I am never free from pain.

Q. What about your right shoulder and your arm? Can you tell us about your trouble there now? [72]

A. Well, my arm is, I can move my arm more freely now than I could, but it's gone back up into my shoulder more.

Q. By "shoulder," which part do you mean?

A. I mean across the back of my shoulder here (indicating).

Q. Indicating the top back of your shoulder?

A. Yes.

Q. Do you mean both shoulders? A. Yes.

Q. You referred earlier in your testimony to the trouble in your arm causing you to have trouble in gripping and lifting. Is that true today or is that different?

A. Well, it's true. I can lift better and my grip is better than it was, but it isn't as good as it was before the accident.

Q. Does weather have any effect on your neck,

(Testimony of Oleta Story.)

your shoulder or arm? Does weather have any effect on your body at all?

A. Well, my doctors seem to think so, yes.

Q. Do you notice any effect?

A. Well, I have those severe headaches so much that I didn't notice if it was weather or anything.

Q. Is there any particular activity that you do during an ordinary day that gives you more trouble in these parts of your body?

A. No, because I don't do hardly anything. My doctor told me not to. [73]

Q. How about sleeping? What effect does this trouble have on your sleeping?

A. It hurts when I sleep.

Q. What happens?

A. Well, it's just the same pain. Some nights I don't sleep hardly at all.

Q. Has the trouble in your body, in your estimation, continued since the time of the accident up to the present time—has it gotten steadily better, steadily worse, or stayed the same?

A. Well, I think it is worse than it was.

Q. What trouble did you have in your neck—what trouble, if any, did you have in your neck prior to this accident?

A. I never did have any trouble with my neck.

Q. What trouble, if any, did you have in your shoulder prior to this accident?

A. I never did have any trouble with my shoulders.

Q. How high can you lift your right arm?

(Testimony of Oleta Story.)

A. Well, I can lift it completely up, but it hurts.

Q. Do you notice that in gripping things with your right arm you drop things from time to time?

A. I have, yes.

Q. Do you know why this is?

A. Well, I just can't hold onto it, and my grip seems to give way, and the pain in my arm, it hurts my arm. [74]

Mr. Fernandez: Your witness.

The Court: Shall we resume at 1:30, counsel?

Mr. Bruno: Fine with me, Judge.

The Court: All right, we'll take a recess until that time.

(Thereupon, this Court was recessed until the hour of 1:30 p.m., same date.) [75]

December 30, 1957—1:30 P.M.

Mr. Fernandez: I just have a couple of questions of my witness, if your Honor please.

(The witness Oleta Story resumed the stand.)

Cross-Examination

(Continued)

By Mr. Fernandez:

Your Honor might be able to follow, at least initially, by question easier than looking at the answers to interrogatories propounded by the defendant, Jean Dobler.

Q. Mrs. Story, do you recall that Mr. Bruno asked you whether you had offered to return the hundred dollars, signed a paper offering to return the hundred dollars to Miss Dobler? A. Yes.

(Testimony of Oleta Story.)

Q. Did you have reference to the paper you signed which are the answers to interrogatories propounded by the defendant, Jean Dobler?

A. Yes.

Q. And you also had reference to the answer to question 8-N, is that right? A. Yes.

Mr. Fernandez: I just wanted to clear that matter up, your Honor, as to what she meant when she said she had signed some papers.

Q. Then, one further question. Do you have some pills in [76] your purse now? A. Yes.

Q. What is that for?

A. They are pain pills.

Q. Do you know what they are?

A. No, I don't know what they are. They are a prescription my doctor give me.

Q. How often do you take these pills?

A. I take them every day.

Q. Do you have any pills for sleeping?

A. Yes.

Q. How often do you take those?

A. Three or four times a week.

Mr. Fernandez: No further questions.

Redirect Examination

By Mr. Bruno:

Q. Mrs. Story, as I understand your testimony, you didn't go to any doctor and seek any medical advice after the accident until December, 1955?

A. That's right.

Q. And at that time you had one visit with the

(Testimony of Oleta Story.)

doctor and that was all? A. That's right.

Q. And you then did not seek medical advice again until September of 1956, almost a year after the accident, is that [77] correct?

A. No, I didn't have the money to go to a doctor.

Q. Would you answer the question please?

Mr. Bruno: And I move to strike the answer the witness gave.

The Court: It may go out.

Q. (By Mr. Bruno): Would you answer the question, please? A. No.

Q. And in September of 1956, you went to the doctor, I believe, either two or three times for some heat treatments?

A. I think it was four or five times that I went to him.

Q. Then you didn't go again until October, at which time you went two or three times again?

A. Yes.

Q. And then you never went to the doctor again until March, 1957? A. Yes.

Q. At which time you went to the doctor once, did you? A. Yes.

Q. And from that time on you never went to the doctor, I believe you said, until October, 1957, is that correct? A. That's right.

Q. At that time you were X-rayed and were given some pills—X-rayed at O'Connor Hospital, given some pills and went home? [78] A. Yes.

Q. During this time since October, 1955, Mrs.

(Testimony of Oleta Story.)

Story, is it your testimony that you never received any injuries during that time?

A. No, I never received any.

Q. Never twisted your neck or lifted something too heavy at home in your housework? A. No.

Q. There was no incident of any kind which would bring on these incidents which were some months apart?

A. No. I had the incidents, but I just couldn't afford to go to the doctor until they were so severe I had to.

Q. Now, as I understand your testimony also, November 29, 1955, is when you signed this release?

A. I beg your pardon?

Q. November 29, 1955, is when you signed this release?

A. That is when I signed the paper, yes.

Q. And prior to that time you said you had some conversation with an agent from Brown Brothers Adjusters who was agent for the American Insurance Company, your insurance company?

A. That is what I thought he was for, yes.

Q. And he told you, did he, he was going to send you a release?

A. When I talked to him on the telephone?

Q. Yes. [79]

A. Yes. He didn't say a release. He said he was going to send some papers to sign.

Q. He didn't say "release"?

A. No. He said so the American Insurance Company——

(Testimony of Oleta Story.)

The Court: A little louder, please.

The Witness: He said so the American Insurance Company could get their money back for having our car fixed.

Q. (By Mr. Bruno): Is it your testimony he said nothing about the return of the \$100 to you?

A. He didn't promise our hundred dollars to us at all.

Q. Did he say anything about it?

A. The only thing they ever said was, if her insurance company paid all of the bills we would receive our hundred dollars back, and if they didn't we wouldn't.

Q. Well, didn't he tell you her company was paying the entire bill for it before you received this release of claim? A. No.

Q. Didn't you even glance at this release of claim before you signed?

A. Oh, yes, I glanced at it when I took it out of the envelope, but I didn't read it.

Q. You knew how much the repair bill was on your car at that time, isn't that correct?

A. I knew it was three hundred and some dollars.

Q. And at that time you knew you were paying Raines some [80] \$25 a month on the \$100 deductible you owed them, isn't that right?

A. That's right.

Q. So when you received this release you noticed it was in the full amount of the repair bill, isn't that correct?

(Testimony of Oleta Story.)

A. On the papers? No, I didn't notice the amount on the paper.

Q. And when you took this paper to your husband, did you discuss the matter with your husband when you asked him to sign it?

A. No, I didn't.

Q. Did your husband read the document?

A. No, I don't believe he did.

Q. You mean you didn't even exchange one word directly concerning the nature of this document that you brought him to sign?

A. The only thing is, I told him we had to go to a notary and sign these papers for our money.

Q. And what the paper was you never discussed?

A. No.

Q. And he never discussed it with you?

A. No.

Q. And neither of you read it? A. No.

Q. You had the paper in your possession one day, then, is [81] that correct?

A. That is correct.

Q. Now, as I understand, you have read and understand the paper? You read it in Court?

A. Yes, I read it.

Q. And your education and knowledge of the English language is sufficient so that you understood what it said?

A. Yes, this morning when I read it in Court.

Q. You read it even before that? You read it in your attorney's office, didn't you?

A. No, I haven't ever read it completely.

(Testimony of Oleta Story.)

Q. Your attorney never showed it to you?

A. He showed it to me, yes, to verify my signature.

Q. And at the time you signed these papers, you were at that time claiming for personal injuries, isn't that correct?

A. I don't understand what you mean.

Q. At the time you signed a release on November 29, 1955, you knew at that time you had sustained some sprain of the neck?

A. Yes, I knew it.

Q. And you described that sprain of the neck to your agent who filled out the accident report?

A. No, I didn't describe it. I said I had a headache and was extremely nervous.

Q. And you told him your neck hurt?

A. That was the second day after the [82] accident.

Q. And you told him your neck hurt?

A. No, I don't think I did. I told him my neck popped and that my head hurt.

Q. So the man from Brown Brothers, as I understand your testimony, told you on the telephone you had to sign this paper so that the insurance company could get their money back?

A. That's right.

Q. And that is all you understood when you signed the paper? A. That's right.

Q. You didn't think you were getting anything out of it?

(Testimony of Oleta Story.)

A. That's right. I didn't think I was getting anything.

Q. And he didn't tell you you were getting anything out of it? A. No.

Q. It is true that when you took your car out of the shop—which was October 15, 1955?

A. I don't know the exact date.

Q. Does that sound about right? A. About.

Q. You paid \$25 on account, on account of the repair bill? A. That's right.

Q. And the balance—well, another \$25 you paid November 6, 1955, is that correct?

A. I don't know just what date. [83]

Q. Do you remember that the balance of \$50 was paid on February 4, 1956?

A. I don't remember just the date that I paid it. I know I paid them.

Q. Mrs. Story, let me ask you, you knew all along from the time of November 29, 1955, you knew all along that you had signed a release for property damage claim and personal injury claim against Jean Dobler and any claims you had against her, did you not? A. No.

Q. And why is it, ma'am, you waited until about one day before the statute of limitations ran on this case before you filed your complaint in Court?

Mr. Fernandez: I want to object to that. I think it calls for a legal conclusion.

The Court: I will permit her to answer.

Q. (By Mr. Bruno): Why is it you waited almost a year?

(Testimony of Oleta Story.)

A. Because I hadn't been to a doctor, and I went to a doctor and he told me the extent of my injury couldn't be determined, that these type of injuries keep coming back like mine had been doing, so after I saw him, I talked to an attorney.

Q. When was that, ma'am?

A. I don't remember the exact date. It was sometime in September, I believe, of 1956.

Q. So you did nothing about the case from October 2, 1955, [84] until sometime in September, 1956?

A. That's right.

Q. And the reason you didn't is because you knew you had signed a release of all claims, isn't that correct?

A. No. The reason I didn't was because I didn't have the money to go to the doctor, and I went on with my suffering as much as I could.

Q. Well, what does that have to do with going to see a lawyer and filing a law suit against Mrs. Dobler?

A. Well, I didn't even think about going to a lawyer until my doctor told me the pain would keep coming back.

Q. And you filed your complaint——

Mr. Bruno: May we have the stipulation that the complaint was filed September 27, 1956?

I have no further questions.

Mr. Fernandez: I have none, your Honor.

The Court: All right, you may step down.

(Witness excused.)

Mr. Bruno: Your Honor, both counsel are of the opinion that your Honor decided to hear all of the testimony from this witness and that the matter could then be put over for a decision.

The Court: No, that isn't what I said. It wasn't my thought, anyway, if I did say it.

Mr. Bruno: Then we misunderstood. [85]

The Court: I think whatever case the plaintiff has to put in, he should put in.

Mr. Fernandez: Oh, I am sorry, your Honor. Before we left at noon I talked to the bailiff and counsel, and said, "Do you think His Honor meant he just wanted Mrs. Story's testimony?"

The Court: I didn't say that. There isn't anything in the record that indicates that. I expected the plaintiff to go ahead with his case.

Mr. Fernandez: I am sorry, your Honor, because otherwise I would have called up the doctors.

The Court: This is the day the case is set for trial, and that is what we are here for, and I am giving you the time for it and I am ready to hear it. That's why we are here.

Mr. Fernandez: I am sorry. We have to call the doctors. I would have done so before I left.

The Court: Did I tell you not to do it? Who told you not to do it? Certainly my bailiff never told you not to bring witnesses.

Mr. Fernandez: I talked to Mr. Bruno and said I wanted to see the Judge to be sure. I asked the bailiff if I could approach the bench through the door, and then said it was my understanding all the Judge wanted was for Mrs. Story's testimony to be

put on today, and I believe Mr. Bruno concurred, and the bailiff concurred, or I would have called Dr. Goddard [86] and Dr. Besson.

Mr. Bruno: I don't think you could get them on that short notice. What you say is correct.

Mr. Fernandez: That was my understanding.

The Court: Well, you didn't get it from me, counsel, any such understanding. I am here ready to hear the case, and if I don't hear it today, I don't know when I will have time to hear it because I go into some other proposition. This is the day that I am ready to hear it.

Mr. Fernandez: We can try to get the doctors.

The Court: Where are the doctors? In San Jose?

Mr. Fernandez: They are in San Jose. Dr. Besson is in Sunnyvale. That is the first doctor I intended to call, and I would have——

The Court: Why didn't you?

Mr. Fernandez: Well, I asked the bailiff and Mr. Bruno what their understanding was of what the judge wanted, which I thought was the testimony of Mrs. Story, because otherwise Mr. Bruno would have wanted to put on his case and he wasn't prepared.

The Court: I told you, Mr. Fernandez—Now, there isn't any doubt about it—I said the plaintiff could finish their case and at that time if you wanted a continuance for the purpose of putting on a defense, I would grant it, but I wanted the plaintiff to put on their case. Anything that you want to [87] put on, I am here ready to hear it.

Mr. Fernandez: We have Mr. Story here.

The Court: Well, put on whatever you have to put on. Have you got the medical report in writing?

Mr. Fernandez: Yes, we have the medical report in writing.

The Court: Have you shown that to counsel?

Mr. Fernandez: I am sorry, I will show it to counsel now, your Honor.

THURMAN B. STORY

called as a witness on behalf of the plaintiff, being first duly sworn, was examined and testified as follows:

The Court: Your full name, please?

The Witness: Thurman B. Story.

Direct Examination

By Mr. Fernandez:

Q. Where do you reside at the present time, Mr. Story? A. 962 Moorpark, San Jose.

Q. Do you recall the date October 2, 1955?

A. Yes.

Q. Where were you residing at that time?

A. The Marin Motel, in Marin County, in San Rafael.

Q. What was your occupation at that time?

A. Operating engineer.

Q. How long had you been so employed? [88]

A. As an operating engineer?

Q. Yes. A. 25 years.

Q. Do you recall that you were traveling on Highway 101 headed toward San Francisco at or

(Testimony of Thurman B. Story.)

near the time of the accident that we are concerned with today? A. That is right.

Q. Do you also recall that the accident happened in the intersection of Highway 101 and Sir Francis Drake Street, normally referred to as the Greenbrae intersection? A. Yes, I do.

Q. What kind of vehicle were you driving that day?

A. A new 1955 Chevrolet, two-door sedan.

Q. Who was with you?

A. My wife and a small nine-year-old boy in the front seat and a 15-year-old boy that was in the back seat.

Q. Did you come up to a stop sign at the Greenbrae intersection? A. A stop light.

Q. When you were, say, 300 feet to the north of the intersection, do you remember the color of the light at that time?

A. Approximately 300 feet, it was green, then it changed to red.

Q. And you came to a stop where? In the intersection?

A. Right at the intersection at the crosswalk line. [89]

Q. What lane were you in at that time?

A. I was in the middle lane.

Q. When you came to a stop, what was the color of the light? A. It was red.

Q. Do you recall that your vehicle was struck in the rear sometime after you had come to a stop?

A. Yes.

(Testimony of Thurman B. Story.)

Q. How long were you stopped before you were struck?

A. It would be hard to determine, but approximately 15 seconds.

Q. Did you see the vehicle that struck you at any time before your automobile was struck?

A. I did not.

Q. Can you describe your stop to us? Was it sudden, gradual? A. Gradual, normal stop.

Q. Now, what was the first indication to you that a vehicle was going to hit you?

A. The impact.

Q. You didn't hear any scraping of brakes or anything? A. No.

Q. What happened to your vehicle after it was struck?

A. Well, we was knocked across the intersection, which is about 50 feet wide. We was knocked clear across it, and the [90] Highway Patrolman taped it and we was knocked 46 feet across the intersection.

Q. After the impact did you have occasion to get out of your vehicle? A. I did.

Q. And did you have occasion to see the damage to the automobile that hit you? A. I did.

Q. What was the damage to that vehicle?

A. The front end was completely demolished.

Q. Did you have occasion to see the damage to your vehicle? A. I did.

Q. And what was the damage there and where?

A. Well, the back trunk compartment was smashed in and upward, and the back bumper was

(Testimony of Thurman B. Story.)

broken, and the frame was bent on the car. I crawled underneath and noticed that because my brakes couldn't brake at that time. After I had driven down to a filling station and got it on the hoist, we had to release the brakes.

Q. Did you have a conversation with the driver of the vehicle that hit you?

A. No, not—just between her and I and the investigating officer, a patrolman.

Q. It was a woman who was driving the car, is that right?

A. Yes, sir. [91]

Q. Was her name Jean Dobler?

A. That is what she said her name was, yes, sir.

Q. Do you recall what the substance of this conversation was between you, Miss Dobler, and the police officer concerning the accident?

A. I asked the lady, didn't she see me stop there, and she said, "No, I didn't." I said, "What reason do you have for running in and tearing my new car up?" And she said, "I am terribly sorry about your car," and that it was all her fault. She had two Navy pilots with her.

The Court: Two what?

The Witness: Two Navy pilots from Hamilton Air Base.

The Court: I still didn't hear.

The Witness: Navy pilots. And I remember the officer kidding one of the pilots about his shirt being burnt.

Mr. Bruno: That is not responsive to anything. I move to strike that.

(Testimony of Thurman B. Story.)

The Witness (Continuing): That's about all. And I told the officer since it was her fault I would like for it to be fixed so there wouldn't be any question about the repairing of my car.

Q. (By Mr. Fernandez): All right, just the conversation between you and Miss Dobler. Does this have reference to the conversation between you and Miss Dobler? [92]

A. That's the conversation we had.

Q. Now, then, can you tell me the condition of the weather at the time of the accident? What was the weather like?

A. It was fair.

Q. What about visibility?

A. It was clear.

Q. Were the roads wet or dry?

A. Dry.

The Court: This was a Sunday, was it?

The Witness: Yes, sir.

Q. (By Mr. Fernandez): Can you tell us what the traffic was like as you came up to the intersection?

A. Very light.

Q. Do you recall what the traffic had been like from the time you left the motel and got onto Highway 101 up until the time of the accident?

A. It was very light.

The Court: It was light, you say?

The Witness: Light traffic. Not much traffic 9:00 o'clock Sunday morning.

The Court: 9:00 o'clock Sunday morning?

The Witness: Yes.

Q. (By Mr. Fernandez): Is that about the time the accident happened?

(Testimony of Thurman B. Story.)

A. Approximately, yes. [93]

Q. Did you continue your trip up to San Francisco after that? A. Yes.

Q. And did you go to your intended destination?

A. No. No, we returned home.

Q. Why was that?

A. Well, my wife was complaining about a headache and extreme nervousness. She wanted to return home.

Q. You have heard your wife testify about conversation that she had with her insurance company. Did you have any conversations with your insurance company concerning the accident? A. No.

Q. Would it be an accurate statement to say your wife had all the dealings with your insurance company? A. That's right. She taken care of all of it.

Q. Your wife—strike that question.

What do you recall about receiving some papers in the mail on or about November 29, 1955?

A. I don't recall the specific date that my wife brought some papers out on the job and told me I would have to sign them.

The Court: Now, he says he didn't have anything to do with it, his wife handled it.

Mr. Fernandez: Yes. I was just asking what happened on November 29th as far as he was concerned. [94]

Q. Have you seen these papers (handing document to the witness)? This release? Just look at the signature. There is no question about the fact that that is your signature?

(Testimony of Thurman B. Story.)

A. That is my signature.

Q. Okay. Now, since the time of the accident and up to the present time, what have you noticed concerning your wife and her physical condition?

A. She hasn't been able to do her work, her housework, and frequently she was in pain, and she has to lie down, oh, I would say three or four times a week, and the doctors has got her on a pain tablet that is evidently pretty strong. I don't know. They seem to ease her down and collect her. That's just about it.

Q. Have you noticed that her complaints are getting steadily more or steadily less, or is that about the same since about the time of this accident?

A. I believe it's about the same. I don't believe it's any worse, and I know it isn't any better.

Mr. Fernandez: You may cross-examine.

Cross-Examination

By Mr. Bruno:

Q. Mr. Story, did you have any conversations at all, sir, with your insurance company, or a representative of your insurance company concerning this accident or damage to your car? [95]

A. No, sir, I didn't.

Q. Did you sign any report to the insurance company concerning the accident?

A. None other than that report you have right there, whatever—release.

Q. And you had no conversation with any representative of the insurance carrier for the other

(Testimony of Thurman B. Story.)

driver, Jean Dobler? A. No, sir.

Q. And you had no conversation, either personally or by telephone, with any agent or representative of Jean Dobler or the insurance company?

A. No, sir, I didn't.

Q. When Mrs. Story brought this release for you to sign, did you look at it?

A. I didn't take time to, no. I didn't specifically read it. She just outlined about what it was and intimated it was some papers releasing our insurance so we could get our car bill paid, and I was busy and I jumped in the car with her and ran down there and signed the thing and back on the job.

Q. You can read, can you not?

A. Yes, sir.

Q. And you say that you had to sign that, it was your understanding you had to sign this to get your car released?

A. She told me it was our insurance, that they was wanting to have the release signed over to them so that they could get [96] this out-of-state insurance company to pay off.

Q. You already had your car when you signed this release?

A. I believe we did. I don't recall.

Q. You got it on October 15, 1956?

A. I think so. I believe we did, yes.

Q. About two weeks after the accident?

A. I don't remember the time.

Q. And you already had made some payments on your deductible? You had paid \$25 at the time you

(Testimony of Thurman B. Story.)

got the car and \$25 on November 6, 1955, isn't that right?

A. I believe she give the check. She made the payment.

Q. You still owed \$50 which you paid in February, 1956?

A. I have some recollection of that, yes.

Q. So that you had the car and the insurance company had paid off their portion of the property damage, and you were paying off your portion of the bill in installments, isn't that correct, at the time you signed this release on November 29, 1955? That was the situation, isn't that correct?

A. Now, you will have to rephrase it. I am sorry, I didn't follow you.

The Court: Well, there isn't any question about it. Mrs. Story testified that that was the situation.

Mr. Bruno: I have no further questions, your Honor. Oh, let me ask you one last question:

Q. You knew that Mrs. Story had signed the release for all [97] personal injuries, isn't that right?

A. No, I didn't know that she had signed a release for all personal injuries. I thought she was signing that release for what she told me she was signing it for. I had no reason to not believe her.

Q. You had an opportunity to read this, didn't you?

A. If I had doubted my wife and had the time, yes.

Q. Did you have an opportunity to read it?

A. I didn't because I am employed by a major

(Testimony of Thurman B. Story.)

company, and they expect my services if I am going to work.

Q. Did you ever have a checking account?

A. Yes.

Q. Did you sign checks?

A. We have a joint account, joint checking account.

Q. Do you read checks when they are made out to you? A. By whom?

Q. By anybody else.

A. The only checks made out to me is by my company to me.

Q. Do you ever sign any receipts?

A. Oh, yes, occasionally like a small receipt for a newspaper bill or something like that.

Q. Do you read those before you sign them?

A. I do. Sometimes I glance at them before I sign them, because I usually know what they are, how much they are, and the nature of them. [98]

Q. Did you ever sign any other releases prior to this one? A. Pertaining to this case?

Q. Pertaining to anything?

A. Oh, yes. Oh, yes, I have signed papers.

Q. And that is true of your wife, isn't it, too?

A. I don't know to what extent our legal documents she signed, no. I wouldn't know that because I haven't been married to her forever.

Mr. Bruno: I have no further questions, your Honor.

(Testimony of Thurman B. Story.)

Redirect Examination

By Mr. Fernandez:

Q. To what grade did you go in school, Mr. Story? A. I finished the 7th.

Q. You didn't have an attorney at the time you signed this release, did you? A. No, sir.

Q. Have you ever been in an automobile accident before? A. No, sir.

Q. Did you ever sign—then you never signed a release from an automobile accident case before?

A. No, sir.

Mr. Fernandez: No further questions.

Mr. Bruno: I have no further questions, your Honor.

The Court: All right, step down.

(Witness excused.) [99]

Mr. Fernandez: If your Honor please, I don't know whether counsel has read this report by Dr. Besson.

The Court: Well, counsel is not required to, and I don't intend to insist that you do it at all. You have a perfect right not to, but if you would stipulate that the report might be received in evidence it would obviate the bringing of the doctor from wherever he is coming from. You don't have to stipulate to that at all, though.

Mr. Bruno: I assumed your Honor had that in mind when your Honor made the remark to counsel, and I read the report with that in mind. If the re-

port had been more consistent with reports rendered in this type of case, I was prepared to stipulate; but I believe Dr. Besson has not had experience in rendering these reports because there is no date stated as to when he saw her, how many times he saw her, what treatment he gave her, many things of that type, so unfortunately I feel forced to state that I can't reasonably in protecting the interests of my client stipulate to the introduction of the report.

Mr. Fernandez: Again I beg your Honor's indulgence on our side. As I said before, I was satisfied to call up Dr. Besson, but it was my understanding that all we were to do was to have Mrs. Story's testimony today.

I know I asked counsel his understanding, and I was about to come into your office, which I should have done, but I asked your bailiff also if that was his understanding, and I [100] believe their answer was in the affirmative.

The Court: Well, what is your suggestion now as to what you want to do?

Mr. Fernandez: Well, if your Honor please, I could call up and find out if we can get the doctor here.

The Court: You can't get them this afternoon from Sunnyvale.

Mr. Fernandez: Continue this to another date and we will be ready to go.

Mr. Bruno: May we do that, and maybe in the meantime your Honor will have an opportunity to consider the question of the release and we may ob-

viate the necessity of taking further evidence if your Honor agrees with my view.

Mr. Fernandez: I believe that is what counsel had in mind initially.

The Court: I would like to get the case completely in and get it behind me. When will you be able to get your doctor?

Mr. Fernandez: Well, I wouldn't profess to know, but I think probably Friday. I can try tomorrow, your Honor. We are prepared to proceed tomorrow.

The Court: How about you? Do you expect to put on any factual testimony or medical testimony?

Mr. Bruno: I would like to communicate with Nurse Dobler, who, as I have informed your Honor, and I am willing to [101] testify, is stationed with the United States Air Force in Germany, and was transferred sometime after the happening of the accident and before I was informed that the case was on trial and was scheduled to go to trial today.

I had, I guess, ten days' or two weeks' notice by reason of the fact that my associate was here in Court, and I found out then that she was in Germany. I would like an opportunity to at least communicate with her by letter or cablegram or somehow to clear up certain things, and I may not present any evidence at all.

The Court: Let's be frank about it. What do you expect to show from this person in Germany? Are you going to take her deposition? Is there any question about whether this was a rear-end collision?

Mr. Bruno: No. Here is the only possibility I

see: She says that the light was green when she approached the intersection, she saw these folks coming to a stop and assumed that they would start right up because the light had just changed. She assumed they would go right on after a moment's hesitation, and they didn't, and that caught her un-awares. That is about the extent of her testimony insofar as the factual situation is concerned.

The Court: Let's suppose she testified just to that situation. Would that be a sufficient defense to running into the rear of a car in front of you? [102]

Mr. Bruno: No, I wouldn't think so, your Honor. I haven't finished.

That was the one possibility, and I feel it wasn't any excuse, probably.

Secondly, and your Honor will appreciate this, I am prepared, if that is all we have, to stipulate to liability; but I can't very well do that never having talked to the client at all and never even having seen her. I would like to get her permission to do that, and if that is the case I won't have any evidence to produce at all.

I am going to recommend to her, frankly, that we stipulate to liability if the case goes to the liability aspect.

So I would suggest, your Honor, since the only evidence is a medical witness, which will be some expense to Mr. Fernandez, probably that is the only witness you will even hear. I have no medical to submit.

The Court: Have you had a medical examination made of the plaintiff?

Mr. Bruno: We have it. We won't, I am sure, introduce any factual testimony at all. So that would leave the probability of only one doctor testifying on the question of damages. So I would suggest it would probably be most suitable to the Court's convenience to continue the matter for a reasonable time for the Court to consider the question of the release, and if the Court decides adversely to the defendant we can fix [103] a date and present the doctor's evidence.

The Court: No, counsel, I am not going to do that. I would continue the case to a definite day and either side would produce such testimony as they may desire. When that is done and all the testimony is in, the matter will be submitted. That is the way I would like to do it.

Mr. Bruno: All right, your Honor.

The Court: It is then all submitted and all before the Court, both the legal issue and the factual issue, and we can then determine what is to be done.

Mr. Bruno: All right, your Honor. Would your Honor desire to continue the matter for sufficient time for me to send one communication to Germany and have time to get it back, and at that time I will be able to tell your Honor frankly there will or will not be any evidence from the defendant. I am pretty sure there will be no evidence from this defendant at all, your Honor.

The Court: In other words, this date to which we continue it, will we expect to have the doctor here at that time?

Mr. Fernandez: That is right.

Mr. Bruno: And I will be ready to proceed, too.

The Court: How much time will that take?

Mr. Fernandez: I think our doctor's testimony will take probably half a day. [104]

The Court: No, I mean how long will it take to get the information so that you are ready to go?

Mr. Bruno: I haven't communicated with Germany recently so I will have to make a guess, your Honor. May I request Friday, January 17?

Mr. Fernandez: That will be all right with us, too.

The Court: Well, do you think you will have a chance to get a reply back from Germany in that time?

Mr. Bruno: I had in mind to ask for as little time as possible.

The Court: But if you are going to do it, I want to give you ample time to get a reply.

(Further colloquy regarding continuance omitted.)

The Court: We will continue it until January 24th at 10:00 o'clock a.m.

(Thereupon, this case was continued to Friday, January 24, 1958, at the hour of 10:00 o'clock a.m.)

[Endorsed]: Filed September 15, 1958. [105]

[Title of District Court and Cause.]

EXCERPT FROM DOCKET ENTRIES

1956

Sept. 27—Filed complaint—issued summons.

* * *

Nov. 19—Filed answer of defendant.

1957

Mar. 28—Filed answers of plaintiff to interrogs. by
Jean Dobler.

Apr. 1—Filed interrogs. by deft. to plaintiff.

Nov. 13—Filed notice by plaintiff of motion to set,
Nov. 25, 1957, with cert. of readiness.

Nov. 25—Ordered, case for trial Dec. 19, 1957.

Dec. 18—Ordered case cont'd. to Dec. 30, 1957, for
trial.

Dec. 30—Ordered case assigned to Judge Hamlin
for trial this date.

Dec. 30—Court trial. Evidence and exhibits intro-
duced and further trial cont'd. to Jan. 24,
1958, at 10 a.m. Memos. to be filed by Jan.
10 and 5 days thereafter.

1958

Jan. 24—Ordered further trial cont'd. to Jan. 31,
1958.

Jan. 31—Further trial. Evidence and exhibits intro-
duced and case submitted, without argu-
ment.

* * *

1958

- Feb. 13—Filed order for judgment for plaintiff vs. deft. in sum \$2,665.00. Counsel for plaintiff to submit findings, conclusions & judgment.
- Feb. 14—Mailed copies order to counsel.
- Feb. 26—Lodged judgment (by plttf).
- Mar. 10—Lodged findings & conclusions (by plttf).
- Mar. 25—Filed findings & conclusions.
- Mar. 25—Entered judgment—filed March 25, 1958—for plaintiff vs. Jean Dobler in sum \$2,665.00 and costs.
- Mar. 25—Mailed notices.
- Apr. 3—Filed notice by deft. of motion for new trial, April 10, 1958, before Judge Hamlin.
- Apr. 9—Ordered motion for new trial cont'd. to April 18, 1958.
- Apr. 18—Ordered after hearing motion for new trial submitted.
- Apr. 22—Filed order denying motion of defendant for new trial.
- Apr. 23—Mailed copies order to counsel.
- May 13—Filed notice of appeal by defendant.
- May 13—Filed appellant's designation of record on appeal.
- May 14—Mailed notices.
- June 4—Filed appeal bond of deft. in sum \$250.00.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO RECORD
ON APPEAL

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, hereby certify the foregoing and accompanying documents and exhibits, listed below, are the originals filed in this Court in the above-entitled case and constitute the record on appeal herein, as designated by counsel for the appellant, Except the reporter's transcript of proceedings is not included for the reason it has not been filed of record in this case :

Excerpt from Docket Entries.

Complaint.

Answer.

Answers of Plaintiff to Interrogatories by Defendant.

Interrogatories by Defendant to Plaintiff.

Notice by Plaintiff of motion to Set Case for Trial.

Order of Court for Judgment.

Findings of Fact and Conclusions of Law.

Judgment.

Notice of Motion for New Trial.

Order Denying Motion for New Trial.

Notice of Appeal.

Appeal Bond.

Designation of Record on Appeal.

Defendant's Exhibits A and B.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court this 16th day of June, 1958.

[Seal] C. W. CALBREATH,
Clerk,

By /s/ MARGARET P. BLAIR,
Deputy Clerk.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO
SUPPLEMENTAL RECORD ON APPEAL

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, hereby certify the foregoing and accompanying document, listed below, is the original filed in this Court in the above-entitled case and constitutes the supplemental record on appeal herein, as designated by attorneys for the appellant:

Reporter's Transcript of Proceedings Dec. 30, 1957.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court this 17th day of September, 1958.

[Seal] C. W. CALBREATH,
Clerk;

By /s/ MARGARET P. BLAIR,
Deputy Clerk.

[Endorsed]: No. 16053. United States Court of Appeals for the Ninth Circuit. Jean Dobler, Appellant, vs. Oleta Story, Appellee. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed June 16, 1958.

Docketed: June 19, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 16053

OLETA STORY,

Plaintiff and Appellee,

vs.

JEAN DOBLER, FIRST DOE, SECOND DOE
and THIRD DOE,

Defendants and Appellants.

STATEMENT OF POINTS

The points upon which appellant will rely on appeal herein are:

1. That the trial court erred in refusing to dismiss the complaint for failure to state a cause of action upon which relief can be granted, after plaintiff's presentation of the evidence and defendant's presentation of the evidence concerning the validity of the release which was signed by the plaintiff.

2. That the court erred in law as to the validity of the release signed by the plaintiff.

3. That the court rendered a judgment not based upon and against the evidence with reference to the validity of the release.

4. The court erred in finding the plaintiff without negligence or fault on her part in executing the release.

/s/ O. VINCENT BRUNO,

Attorney for Appellant.

Affidavit of service by mail attached.

[Endorsed]: Filed September 23, 1958.

No. 16,053

United States Court of Appeals
For the Ninth Circuit

JEAN DOBLER,

vs.

OLETA STORY,

Appellant,

Appellee.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

Honorable O. D. Hamlin, Judge.

APPELLANT'S OPENING BRIEF.

O. VINCENT BRUNO,

NOEL B. GASSETT,

447 North First Street,

San Jose 12, California,

Attorneys for Appellant.

FILED

JAN 19 1959

PAUL P. O'BRIEN, CLERK

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No. 16,053

United States Court of Appeals For the Ninth Circuit

JEAN DOBLER,

Appellant,

vs.

OLETA STORY,

Appellee.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

Honorable O. D. Hamlin, Judge.

APPELLANT'S OPENING BRIEF.

JURISDICTION.

1. The United States District Court for the Northern District of California, Northern Division, had jurisdiction of this matter pursuant to 28 U.S.C.A. § 1332 which provided:

“a. The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of \$3,000.00, exclusive of interest and costs, and is between:

(1) Citizens of different states.”

This court has jurisdiction to hear the appeal in this matter pursuant to 28 U.S.C.A. § 1291 which provides:

“The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court.”

2. Paragraph I of the complaint on file in this matter alleges:

“That she is a citizen of the State of California and the defendant Jean Dobler is a citizen of the State of Texas. The matter in controversy exceeds, exclusive of interest and costs, the sum of Three Thousand Dollars.” (R.T. p. 3.)

The answer filed by defendant Oleta Story admits the jurisdictional facts alleged by the complaint (R.T. pp. 6-9).

The district court entered and filed its final decision on March 25, 1958 (R.T. pp. 12-13).

**SPECIFICATION OF ERRORS RELIED
UPON BY APPELLANT.**

I. Error of law by the trial court in finding that the release signed by the plaintiff did not bar recovery by her in this action (R.T. p. 12).

II. Error of the trial court in admitting parole evidence to vary the terms of an integrated written instrument. This evidence was objected to at the time of the trial and the grounds given were as follows:

“Objected to, your Honor, upon the ground that it calls for evidence attempting to vary the terms of the written document” (RT p. 47); and

“Your Honor, I think that is completely incompetent, irrelevant and immaterial, what she thought, because the theory of meeting of minds under contract was drawn out years ago. It is what is definitely stated in the written word that counts.” (R.T. p. 51.)

The evidence thus erroneously admitted was testimony of plaintiff that she thought she was signing a paper for her insurance company to get the money back which it had spent on repairing her car; this was the only thing she understood the contract to accomplish (R.T. pp. 48-56).

INTRODUCTION.

This action was commenced against the named defendant by the filing of a complaint on September 27, 1956. The complaint alleged two causes of action, the first that defendant Jean Dobler negligently operated a certain automobile, and the second that defendant Jean Dobler negligently operated a certain automobile while the agent and servant and while acting within the course of her employment of her employer, Third Doe. Service was effected and defendant Jean Dobler appeared herein by filing her answer on November 19, 1956 (R.T. p. 8). The answer of Jean Dobler denied any negligence and for an affirmative defense alleged that on November 29, 1955 the plaintiff for valuable

consideration released the defendant from all liability to the plaintiff on any and all claims of the plaintiff against the defendant, including the alleged claim set forth in the complaint. The matter came on regularly for trial before His Honor, Judge Oliver D. Hamlin before the court without a jury on December 30, 1957. After hearing the evidence offered on December 30, 1957 the trial was continued until January 24, 1958, at which time further evidence was heard and the case submitted. After due consideration the court ordered judgment for the plaintiff. Findings of fact and conclusions of law were made by the court on March 24, 1958. A motion for new trial was made by the defendant. After consideration, the trial court denied the motion for a new trial. Thereafter this appeal was duly prosecuted.

STATEMENT OF FACTS.

Plaintiff was involved in an automobile accident on October 2, 1955 (R.T. p. 31). Two days after this accident, she reported this accident to an agent of her own insurance company and filled out an accident report for it (R.T. pp. 31-32). At the time she completed this report to her insurance company, she was suffering from headaches and neck pain as a result of the accident (R.T. pp. 34-35). On November 29, 1958 she signed a document before a notary public entitled, "Release of All Claims" (R.T. p. 36 [defendant's exhibit "B"])). Prior to signing this release, plaintiff had received it in the mail from an

agent of her own insurance company (R.T. p. 37).
The contract of release reads in full as follows:

“Release of All Claims

For and in consideration of the payment to me/us of the sum of three hundred thirty and 80/100 dollars, the receipt of which is hereby acknowledged, I/we, being of lawful age, do hereby release, acquit, and forever discharge Jean I. Dobler, his/her heirs, executors and assigns, from any and all liability now accrued or hereafter to accrue on account of any and all claims or causes of action which I/we now or may hereafter have for personal injuries, damage to property, loss of services, medical expenses, losses or damages of any and every kind or nature whatsoever, now known or that may hereafter develop, by me/us sustained or received on or about the 2nd day of October, 1955, through automobile accident in or near Greenbrae intersection, Marin County, California, and I/we hereby declare that I/we fully understand the terms of this settlement and voluntarily accept said sum for the purpose of making a full and final compromise, adjustment and settlement of the injuries and damages, expenses and inconvenience above mentioned.

It being further agreed and understood that this settlement is a compromise of a disputed claim and that the payment is not to be construed as an admission on the part of the party or parties hereby released of any liability whatever in consequence of said accident.

I/We further state that the foregoing release has been carefully read and I/we know the con-

tents thereof and have signed the same as my/our own free act and have not been influenced in making this settlement by any representation of the party or parties released.

Executed at San Rafael, this 29th day of November, 1955.

Witnesses:

Mrs. Dawn E. Bowen

Address

4136 Redwood Hwy.,

San Rafael, Calif.

Dorothy McDonald

Address

4136 Redwood Hwy.,

San Rafael, Calif.

CAUTION: READ BEFORE SIGNING BELOW

Thurman Story

Oleta Story

American Insurance Co.

By E. Godsall, General Adjuster

Acknowledgment

State of California,

County of Marin.

Before me, this 29th day of November, 1955, personally appeared Thurman Story and Oleta Story, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged that he/she understands its contents and executed the same for the purposes and consideration therein expressed.

Given under my hand and seal of office this 29th day of November, 1955. Helen Rutledge, Notary Public—In and for the State of California, County of Marin."

Plaintiff had ample time to read the document before she signed it (R.T. p. 38). Plaintiff was not forced to sign the release (R.T. p. 28). She was able to read and understand the document (R.T. pp. 39-40). She signed it freely and willingly (R.T. p. 41). Some time after signing the release, she received a check in the sum of \$330.81 from her insurance company (R.T. p. 42). She sent this check back to her own insurance company after properly endorsing it, and then in a few weeks she received a check from her insurance company for \$100.00 (R.T. p. 43). At no time did defendant Jean Dobler, nor anyone representing her, communicate with plaintiff in regard to the automobile accident or the release which plaintiff signed (R.T. p. 35).

LEGAL ARGUMENT.

I.

THE RELEASE SIGNED BY PLAINTIFF OLETA STORY WAS AND IS A VALID AND BINDING CONTRACT.

1. There was clearly an offer and acceptance of the terms of the contract. Plaintiff received the written contract, which she signed, in the mail (R.T. p. 36). She accepted its terms by signing it before a notary public (R.T. p. 39). The next day she had two persons witness her signature (R.T. p. 39). One who signs an instrument, which on its face is a contract, is deemed to assent to all of its terms, and cannot escape liability on the ground that he has not read it. *Greve v. Taft Realty Co.* (1929), 101 C.A. 343, 351;

281 P. 641; *George v. Bekins Van & Storage Co.* (1949), 33 C. 2d 834, 848; 205 P. 2d 1037. Plaintiff received defendant's written offer and she clearly accepted it by signing it. When there is an offer by one party and acceptance by the other, a contract is created between them. A valid bilateral contract was formed by a mutual exchange of promises. *Tuso v. Green* (1924), 194 C. 574, 580-581; 229 P. 327.

2. There was valid and adequate consideration to support the contract which plaintiff signed.

As recited in the contract which plaintiff signed, it was supported by a promise to pay to defendant \$330.80 (defendant's exhibit "B", supra). There is no question, of course, that money is adequate and valuable consideration to support a contract, *Lindley v. Blumberg* (1907), 7 C.A. 140, 144; 93 P. 894. Plaintiff testified that she received a check for \$330.80 which she voluntarily endorsed and sent to her insurance company (R.T. p. 42). She later received a check for \$100.00 which she endorsed and cashed (R. T. p. 44). She never returned said moneys, nor offered to return them, but used them for her own purposes; never objecting or complaining as to the amount.

When there is valid consideration, the law will not inquire into its adequacy, *Brawley v. Crosby Research Foundation, Inc.* (1946), 73 C.A. 2d 103, 112; 166 P. 2d 392. Where the consideration agreed upon has been accepted, the acceptance constitutes a waiver of any claim of inadequacy, *Lerma v. Flores* (1936), 16 C.A. 2d 128, 130; 60 P. 2d 546.

3. There was no fraud nor deceit used by defendant, nor any agent of defendant, which induced plaintiff to sign the contract of release.

Plaintiff testified that at no time did she deal with defendant Jean F. Dobler, nor with anyone representing her (R.T. p. 35). She received the contract in the mail and had ample opportunity and time to read it (R.T. pp. 36-38). She was able to read and understand the document at the time of the trial (R.T. p. 40). It is obvious that no one was attempting to conceal from plaintiff what the document said. If someone had been attempting to do this, he certainly would not have sent the contract to her giving her ample opportunity to read it and if she wished, seek advice. At the time she signed it no one was present, except her husband and the notary (R.T. p. 41).

4. There was absolutely no duress or force used to make plaintiff sign the release. She testified to this several times. When asked whether or not she was forced to sign it, she replied without hesitation that she was not forced to sign it (R.T. pp. 39-40). She stated upon questioning that she signed it *freely and willingly* (R.T. p. 41).

5. There was no *mutual mistake* of the parties when this contract was entered into. There is absolutely nothing in the transcript of record of this case which even suggests, let alone shows, that there was any mutual mistake attendant upon the making of this contract. A party claiming mistake, as the plaintiff is claiming in this action, must establish the mistake, as the law does not presume mistake of fact.

Megee v. Fasulis (1943), 57 C.A. 2d 275, 285; 134 P. 2d 815. Plaintiff has completely failed to show any mutual mistake or any mistake whatsoever.

6. There was no *unilateral mistake* on plaintiff's part when she signed the release. The only ground upon which plaintiff attacks the validity of the release signed by plaintiff is that said release was signed because of a unilateral mistake on plaintiff's part. It is the well settled rule that if there is no ambiguity in the language of the contract, and neither party is at fault, unilateral mistake will not prevent formation of a contract. Under the objective test, a "meeting of the minds" is unnecessary, and a party may be bound though he misunderstood the terms of the proposed contract, and actually had a different undisclosed intention, *Brant v. California Dairies, Inc.* (1935), 4 C. 2d 128, 133; 48 P. 2d 13. In *Brant v. California Dairies, Inc.* supra, the parties had written a series of letters in regard to an agreement to market milk. The defendant argued that the contract was not binding since he believed that the contract meant something other than was written. The court stated that the outward manifestation or expression of assent is controlling in the absence of mistake or fraud. That is exactly the situation in the present case. There was no mistake on the part of the plaintiff; she merely believed that the document she signed enabled her insurance company to get back its money from defendant's insurance company (R.T. pp. 54-55), in spite of the clear language of the document that she signed which released all claims against defendant. Plaintiff did not communicate this belief

to anyone, nor did she make any mention of this undisclosed intention.

When a party, negligent in not informing himself of the contents of a written contract, signs and accepts the agreement with full opportunity of knowing the true facts, he cannot, in the absence of fraud or misrepresentation, avoid liability on the ground that he was mistaken concerning the terms. He cannot be heard to say that he did not read the contract and does not know its contents. *Knox v. Modern Garage & Repair Shop* (1924), 68 C.A. 583, 587; 229 P. 880; *Greve v. Taft Realty Co.* (1929), 101 C.A. 343, 351; 281 P. 641; *Palmquist v. Mercer* (1954), 43 C. 2d 92, 98; 272 P. 2d 26. There is no claim in this case that there was fraud or misrepresentation by the defendant or any agent of defendant for the simple reason that neither defendant nor any agent of defendant ever contacted or communicated in any way with plaintiff prior to the time she signed the release. Plaintiff admits she is able to read and understand the release (R.T. p. 40). Now, however, plaintiff claims that the release should not be binding upon her because she was mistaken as to what she thought it said. She was not interested enough at the time to even read it. The release was sent through the mail to her residence (R.T. p. 36). No one rushed her or told her not to read the release. She had ample opportunity to read it before she signed it and sent it back to her agent (R.T. p. 38). At the time she signed the release, her neck and head were hurting her as a result of the accident (R.T. pp. 72-86), yet she signed

a document absolving defendant of any and all liability to her for any injuries she might have suffered in the accident. There is no issue as to whether or not she was injured when she signed the release; there was no mistake in this regard. Plaintiff has absolutely failed to show any mistake on her part which would allow her to avoid the terms of the contract which she willingly signed. It was incumbent upon her to establish any such mistake. *Megee v. Fasulis*, supra.

The only showing which might possibly be said that she has made is that she did not read the instrument, and because of this was mistaken as to its contents. As pointed out above, one signing a contract without informing himself of its contents when he has ample opportunity to do so cannot avoid liability on ground he was mistaken concerning its terms, in absence of fraud or misrepresentation. *Knox v. Modern Garage & Repair Shop*, supra.

II.

PLAINTIFF DID NOT COMPLY WITH THE PROVISIONS OF THE CALIFORNIA CODE OF CIVIL PROCEDURE RELATING TO RESCISSION OF A CONTRACT.

1. § 1566 C.C.P. states:

“A consent which is not free is nevertheless not absolutely void, but may be rescinded by the parties, in the manner prescribed by the chapter on rescission.”

§ 1567 C.C.P. goes on to say that:

“An apparent consent is not real or free when obtained through . . . 5. Mistake.”

In the case at bar plaintiff's only contention is that she is able to avoid the effect of the release which she signed because there was an unilateral mistake on her part as to its effect. Assuming for the purpose of argument that there was a mistake present which would allow rescission and avoidance of this contract, it would be necessary for plaintiff to follow the procedure set forth by the California Code of Civil Procedure. Even if there had been an unilateral mistake, the contract would not be void, but merely voidable. § 1566 C.C.P.

A voidable contract is valid until disaffirmed by the party entitled to avoid it. *Matthews v. Ormerd* (1903), 140 C. 578, 582; 74 P. 136; *Garcia v. California Truck Co.* (1920), 183 C. 767, 769, 770; 192 P. 708.

Since in case of mistake a contract is only voidable and not void, it becomes incumbent upon the party wishing to avoid the contract to follow certain steps. § 1566 C.C.P. states that the contract

“... may be rescinded by the parties in the manner prescribed by the Chapter on Rescission.”

The chapter on Rescission in the C.C.P., § 1691, sets forth the procedure necessary to effect rescission when it is not effected by consent. Calif. C.C.P. § 1691 reads as follows:

“Rescission, how effected. Rescission, when not effected by consent, can be accomplished only by the use, on the part of the party rescinding, of reasonable diligence to comply with the following rules:

1. He must rescind promptly, upon discovering the facts which entitled him to rescind, if he is free from duress, menace, undue influence, or disability, and is aware of his right to rescind; and,
2. He must restore to the other party everything of value which he has received from him under the contract; or must offer to restore the same, upon condition that such party shall do likewise, unless the latter is unable or positively refuses to do so."

2. It is to be noted that the first requirement is that the party must rescind promptly upon discovering the facts which entitle him to rescind assuming, of course, that he is free from duress, menace, undue influence, or disability and he realizes he has a right to rescind. There is no evidence in this case that there was any duress, menace, undue influence, or disability.

In the case of *Gedstad v. Ellichman* (1954), 124 C.A. 2d 831, 834; 269 P. 2d 661 wherein the plaintiff was seeking to avoid a contract, the court stated that when one is seeking to rescind a contract, diligence must be shown by him; whereas in other actions laches is an affirmative defense to be alleged by the defending party. The court further stated that a delay of more than one month in serving notice of rescission requires explanation.

In the case at bar, plaintiff at no time rescinded the release. Assuming that she had forgotten or did not know she signed a release, it certainly was brought to her attention when defendant specifically pleaded the release as a bar to the action in her answer (R.T.

p. 7). Said answer was filed with the court on November 19, 1956 and served by mail upon plaintiff's attorney (R.T. p. 8). Yet plaintiff still elected to take no action to attempt to avoid the effect of the release. Even at the time of trial plaintiff did not give notice of rescission. The transcript of record is absolutely devoid of any offer to rescind. Over nine months elapsed from the time plaintiff signed the release and the time she filed her verified complaint (R.T. pp. 6, 36). Nothing at all was done by plaintiff during this period which would indicate to defendant that she was going to attempt to avoid the consequences of the general release which she signed.

More than one year elapsed between the time defendant filed her answer affirmatively pleading the release signed by plaintiff and the time the case came before the court for trial. Again absolutely nothing was done by plaintiff indicating that she wished to avoid the effects of the contract she had voluntarily entered into.

From the time that the fact she had signed a release was clearly pointed out to her by defendant's affirmatively pleading it until the present time, plaintiff has been represented by legal counsel. It certainly cannot be said, in view of this, that she was without legal advice and did not know what her rights and duties were. It must be presumed that these were pointed out to her by her counsel.

3. Not only is it necessary to give notice of rescission promptly, but it is necessary to restore to the other party everything of value which the party wish-

ing to rescind has received under the contract (California C.C.P. § 1691). In this case there was absolutely no evidence that there had been restoration of the money which plaintiff received pursuant to the contract. On the contrary, it appears that plaintiff's counsel thought that it might be a good idea to offer to restore the money at the time of trial, but then for some reason did not do so (R.T. p. 30).

Plaintiff's counsel's exact words are as follows:

"Now, when I came into Court and made this statement earlier, I just wanted to point that fact out to you and then go on to say if counsel wants us to make a formal tender of what he considers what the California law is, I will make it because I believe we can do it at any time.

The Court. Well, I don't think you can go on the basis that if counsel wants you to do something. I think you should do whatever you want to do yourself and then let's determine whether it is sufficient or not. But I don't think you can take the position that you will only do something if counsel wants you to do it.

Mr. Fernandez. No. I wanted to be sure I had that covered under all circumstances, your Honor.

The Court. All right." (R.T. p. 30.)

After the foregoing remarks, neither plaintiff nor plaintiff's counsel ever brought up the subject of restoration again. What was said certainly cannot be considered an offer to restore since the remark was addressed to the court and was contingent upon defendant's attorney wanting plaintiff to restore. As the court properly pointed out, it isn't what opposing

counsel wishes, it is what the law requires. No restoration was subsequently offered or made by plaintiff.

4. The language of California C.C.P. § 1691 requiring prompt notice of rescission and restoration of things of value received under the contract is not merely permissive or suggestive, but on the contrary it is mandatory. The section states in clear language that it provides the only way which rescission can be accomplished other than by consent of the parties.

The findings of fact, as made by the court in this case, do not state that plaintiff complied with either of the requirements of California C.C.P. § 1691. Compliance with these provisions is necessary in order for plaintiff to avoid the effects of the contract she signed and consented to. The only reference to the release to be found in the findings of fact is the following:

“That at the time that the plaintiff signed a release of all claims, releasing defendant from all liability for the accident of October 2, 1955, the plaintiff did not know or understand that the release signed by her covered her claim for personal injuries, and that the plaintiff believed that at the time she signed the release she was releasing only her claim for property damage to her 1955 Chevrolet automobile, owned jointly by plaintiff and her husband” (R.T. p. 11).

In its conclusions of law, the court stated in Paragraph II:

“That the release signed by the plaintiff did not bar recovery by her in this action.”

There is absolutely nothing upon which to base this conclusion of law in that there is no finding of fact

that plaintiff rescinded the release which she entered into, or any other reason why she could avoid her valid contract of release. Actually there was no finding of fact by the court that there was a mistake by plaintiff, but merely a general finding that she did not know or understand that the release signed by her covered her claim for personal injuries. This is not a finding of mistake which would allow rescission.

In *Cilibrasi v. Reiter* (1951), 103 C.A. 2d 397, 399; 229 P. 2d 394 the court states the law as follows:

“It is a familiar principle of adjective law that in the absence of the rescission of a contract of settlement of a claim for personal injuries accomplished according to law, and of restoration of the consideration paid for the release of the claim the release of the tortfeasor is a valid contract and prevents recovery on the disputed claim.”

In the case at bar plaintiff is bound by the contract of release which she signed, and it is a bar to any action on her claim.

III.

TO ALLOW PLAINTIFF TO AVOID THE CONSEQUENCES OF THE CONTRACT OF RELEASE WHICH SHE VOLUNTARILY SIGNED WOULD LEAD TO UTTER CONFUSION AND MAKE A MOCKERY OF CONTRACT LAW.

1. The contract which plaintiff signed only consisted of 28 lines of printed material, including the acknowledgment (defendant's exhibit “B”, supra). It was certainly not an onerous task for plaintiff to

read this very simple document. At the top of the document it states in large bold face type that it is a "RELEASE OF ALL CLAIMS." Immediately above the line where plaintiff signed, there is the further warning in capital letters: "CAUTION: READ BEFORE SIGNING BELOW".

Yet in spite of all this, plaintiff now claims she did not read the document and did not know what terms it contained. Now plaintiff claims that because she didn't read it, although she had ample opportunity to do so (R.T. p. 38), she isn't bound by it. If this proposition is true, then no contract ever entered into has any value whatsoever. If the party who signs the contract later decides it would be to his benefit not to be bound by it, he need only say he didn't read it and therefore didn't realize what its terms were. This is all that would be necessary to completely avoid the effects of the contract. This is not the law. If it were, contracts would be mere shams. There would be no way that a person in plaintiff's position could be bound, since although one could try and make a person read a contract, one would never know for sure that he actually read it or merely looked at it.

Business dealings and other matters based on contracts would be merely a gamble that the parties would carry through the agreement since at any time they could ignore it by using the theory of plaintiff in this case. Public policy would not allow such a situation to exist. Releases in law are considered favorably and are encouraged. *Cilibrasi v. Reiter*, supra. If plaintiff's position prevails, no disputed

claim would ever be settled since the party attempting to settle would never be sure he would be released from liability.

IV.

THE TESTIMONY OF THE PLAINTIFF AS TO WHAT SHE WAS TOLD ABOUT THE CONTRACT AND WHAT SHE UNDERSTOOD IT TO MEAN WAS IMPROPERLY ADMITTED BY THE TRIAL COURT.

1. § 1625 of the California Civil Code states:

“[Effect of written contract.] The execution of a contract in writing, whether the law requires it to be written or not, supersedes all the negotiations or stipulations concerning its matter which preceded or accompanied the execution of the instrument.”

§ 1856 of the California Code of Civil Procedure states:

“An agreement reduced to writing deemed the whole. When the terms of an agreement have been reduced to writing by the parties, it is to be considered as containing all those terms, and therefore there can be between the parties and their representatives, or successors in interest, no evidence of the terms of the agreement other than the contents of the writing, except in the following cases:

1. Where a mistake or imperfection of the writing is put in issue by the pleadings;
2. Where the validity of the agreement is the fact in dispute. But this section does not exclude other evidence of the circumstances under which the agreement was made or to which it relates,

as defined in section eighteen hundred and sixty, or to explain an extrinsic ambiguity, or to establish illegality or fraud. The term agreement includes deeds and wills, as well as contracts between parties.”

It is almost universally agreed that the parole evidence rule is not a mere rule of evidence concerned with the method of proving an agreement. Extrinsic evidence is excluded since it cannot possibly show what the agreement was since this is determined as a matter of law to be the writing itself. *VanFleet-Durkee, Inc. v. Oyster* (1949), 91 C.A. 2d 411; 205 P. 2d 32; *El Zarape, etc. Factory v. Plant Food Corp.* (1949), 90 C.A. 2d 336, 344; 203 P. 2d 16; *Guerin v. Kirst* (1949), 33 C. 2d 402, 410; 202 P. 2d 10.

If on its face, the document purports to be a complete expression of the agreement, it is conclusively presumed to contain all of the agreed terms, and extrinsic evidence is excluded. *Thoroman v. David* (1926), 199 C. 386, 390; 245 P. 513; *El Zarape etc. Factory v. Plant Food Corp.* supra.

The document signed by plaintiff in this case (defendant's exhibit “B”, supra) is clearly an integrated document. There is nothing indicated in the agreement which would make it necessary to look outside the document for interpretation. It is clear and complete on its face.

The evidence introduced by plaintiff and admitted into evidence tended to show that the agreement was not intended to cover her personal injuries although the agreement clearly states that it does cover personal

injuries. Any such evidence clearly tends to vary the terms of this written document and so is inadmissible.

CONCLUSION.

For the reasons stated herein, it is respectfully submitted that the judgment of the trial court below should be reversed and the cause remanded with a direction to the trial court to enter judgment for the defendant Jean Dobler.

Dated, San Jose, California,
January 16, 1959.

Respectfully submitted,
O. VINCENT BRUNO,
NOEL B. GASSETT,
Attorneys for Appellant.

No. 16,053

United States Court of Appeals
For the Ninth Circuit

JEAN DOBLER,

VS.

OLETA STORY,

Appellant,

Appellee.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

Honorable O. D. Hamlin, Judge.

APPELLEE'S REPLY BRIEF.

LEWIS, SCHER & FERNANDEZ,

P. O. Box 816, Sunnyvale, California,

Attorneys for Appellee.

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No. 16,053

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Appellant,

vs.

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Northern District of California,
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Honorable O. D. Hamlin, Judge.

APPELLEE'S REPLY BRIEF.

STATEMENT OF JURISDICTION.

The plaintiff-appellee adopts the statement of jurisdiction contained in defendant's brief. (App.Op.Br., pp. 1-2.)

NATURE OF THE CONTROVERSY.

This is an appeal by the defendant from a judgment for the plaintiff in an action to recover damages for injuries suffered by the plaintiff in an automobile accident.

The defendant virtually conceded responsibility for the accident (R.T. 94, 102-104) but defended primarily on the ground that her liability was discharged by a release procured by plaintiff's own insurance company. (Exhibit B.) The trial court, sitting without a jury, found that the release was invalid because it was induced by a serious mistake of fact. (Findings of Fact, Paragraph V.)

It will be shown that the existence of such a mistake is sufficient to invalidate the release and that there was substantial evidence supporting the finding of mistake. Consequently, it is submitted that the judgment should be affirmed.

STATEMENT OF THE CASE.

On October 2, 1955, at approximately 9:00 a.m., plaintiff was involved in an automobile accident at the intersection of Highway 101 and Sir Francis Drake Boulevard, normally referred to as the Greenbrae Intersection. At that time plaintiff's vehicle was being driven by her husband and was stopped for a red light at the aforesaid intersection. Plaintiff's vehicle was stopped for approximately 15 seconds when it was struck in the rear by the vehicle being driven by the defendant Jean Dobler. (R.T. 91-95.)

Subsequently, plaintiff entered into a transaction which eventually resulted in the release set forth in appellant's opening brief, pp. 5-6. The only dealings she had concerning this release were with agents of her own insurance company. (R.T. 35-36.) She even-

tually signed the release, but didn't understand it. (R.T. 40.) She did not read the document before signing. (R.T. 40.) She was trusting her own insurance company and believed that these were papers which would allow them to collect their money for having her car fixed. (R.T. 40-41.) In this regard appellee testified as to the negotiations she had prior to the signing of the release and her understanding at the time of its signing. At no time was there any discussion regarding a settlement for her physical trouble, nor a settlement for her medical bills incurred or to be incurred in the future. (R.T. 53.) At no time prior to the signing of the release was she advised that this was a total payment for her entire case. (R.T. 84.) Nor did she believe or know at the time of signing the release that she was to get anything as a consequence of it. (R.T. 86-87.) She believed that she had to sign the papers in order that her insurance company might get their money back. (R.T. 54-55.) And if they got their money back and the appellant's insurance company paid all of the damages on the car, then respondent and her husband would receive their \$100.00-deductible back. (R.T. 53.)

At no time during the course of the negotiations relating to the signing of the release did she have the advice of an attorney. (R.T. 47.) Respondent also testified that she had reached only the eighth grade in school. (R.T. 47.)

The amount of the settlement was \$330.80; this was the exact amount—to the penny—of the property damage to plaintiff's car. (R.T. 44 and 47.)

After trial of this matter, the court, sitting without a jury, found:

1. That plaintiff was a citizen of California and defendant was a citizen of Texas;
2. That the defendant's vehicle struck the rear end of the vehicle in which plaintiff was riding on the 2nd day of October, 1955, at the intersection of U. S. Highway 101 and Sir Francis Drake Boulevard;
3. The plaintiff suffered general damages in the sum of \$2,400.00;
4. That plaintiff incurred medical expenses of \$265.00;
5. That the plaintiff at the time of signing the release of all claims did not know or understand that the release covered her claim for personal injuries, but believed that she was releasing only her claim for property damage;
6. That plaintiff was not negligent or careless;
7. That the injuries of plaintiff were not the result of an unavoidable accident or misadventure.

The trial court rendered judgment in favor of plaintiff and concluded that:

1. The court had jurisdiction of the controversy;
2. That the release signed by plaintiff did not bar her recovery;
3. That the plaintiff was entitled to judgment against defendant for \$2,400.00 general dam-

ages; \$265.00 special damages; and costs of suit.

SUMMARY OF ARGUMENT.

I. The judgment must be affirmed if it is supported by substantial evidence.

II. The judgment is supported by evidence that the release was induced by mistake and was not a valid contract.

A. Plaintiff did not consent to any such release.

B. Proof of a mutual mistake was not necessary.

C. Whether or not defendant induced the mistake is not determinative.

D. Plaintiff was not negligent as a matter of law.

E. A release induced by mistake is not valid.

III. A tender of the consideration was not essential.

IV. The judgment is an equitable one.

V. The parol evidence rule does not apply.

ARGUMENT.

I.

THE JUDGMENT MUST BE AFFIRMED IF IT IS SUPPORTED BY SUBSTANTIAL EVIDENCE.

The judgment of the court, sitting without a jury, in this case, was in favor of the plaintiff Oleta Story and against the defendant Jean Dobler. The defend-

ant has appealed the decision of the court and has urged four points on appeal:

1. The release signed by plaintiff was and is a binding and valid contract.
2. Plaintiff did not comply with the provisions of the California Code of Civil Procedure relating to rescission of a contract.
3. To allow plaintiff to avoid the consequences of the contract of release which she voluntarily signed would lead to utter confusion and make a mockery of contract law.
4. The testimony of the plaintiff as to what she was told about the contract and what she understood it to mean was improperly admitted by the trial court.

It is apparently appellant's contention that no matter what the facts may be, as a matter of law this court must find that the plaintiff is barred from recovery because of her having signed the release quoted verbatim on pages 5 and 6 of appellant's opening brief.

Initially, the first question must be, "What law will govern the decision here?" It can be readily seen that this action arose due to the occurrence of an automobile accident on U. S. Highway 101 in the State of California, and that the jurisdiction of the Federal Court attaches because the action is between citizens of different states, 28 U.S.C.A. §1332. Therefore, where Federal jurisdiction depends upon diversity of citizenship, substantive rights are to be adjudged ac-

cording to state or local law. *Erie RR Co. v. Tompkins*, 304 U.S. 64, 82 L. ed. 1188, 58 S.Ct. 817; this court must look to the decisions of the California State Courts in order to make its determination on our particular factual situation.

It is the time-honored rule in California that all substantial conflicts in the evidence must be resolved in favor of the respondent, and all legitimate and reasonable inferences indulged in to uphold the findings if possible. *Richter v. Walker*, 36 C2d 634, 640; *Kircher v. Atchison, T. & S.F. Ry. Co.*, 32 C2d 176, 183-185; *Nichols v. Mitchell*, 32 C2d 598, 600-601; *Crawford v. Southern Pac. Co.*, 3 C2d 427, 429.

It is also the rule that a judgment will not be set aside on appeal because of a failure to make an express finding upon an issue if a finding thereon, consistent with the judgment, results by necessary implication from the express findings which are made. *Richter v. Walker*, *supra*.

And in determining whether a mistake of fact existed, the appellate court must accept as conclusive any decision of the trial court in a factual conflict if there is sufficient evidence to support it. A mere conflict in the testimony as to the mistake does not necessitate a denial of relief. *Reid v. Landon*, 166 A.C.A. 573, 581; *Nelson v. Meadville*, 19 CA2d 68; *Hutchinson v. Ainsworth*, 73 Cal. 452.

If it is appellant's contention that some particular issue of fact is not sustained by the evidence, he is required to set forth in his brief all of the material

evidence on the point and not merely his own evidence. If this is not done, the error is deemed waived. *Tesseyman v. Fisher*, 113 CA2d 404, 407; *Kruckow v. Lesser*, 111 CA2d 189, 200.

In applying these rules, it is obvious that if appellant is relying on insufficiency of the evidence to sustain any material fact found by the trial judge, her assertion of error in this regard must fail since in fashioning her arguments, she has selected from the record only such parts of the evidence favorable to herself by emphasizing the evidence deemed favorable to her side of the case, and discounting or ignoring evidence favorable to respondent's contentions.

The rule of appellate review of evidence previously cited is essentially the same in the Federal Courts. As provided in Rule 52 of the *Federal Rules of Civil Procedure*,

“... Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of witnesses.”

And it is the rule that findings of fact are conclusive upon the appellate court unless clearly erroneous. *Blackhawk Hotels Co. v. Bonfoey*, 227 F2d 232, 56 ALR2d 1047, 1053; *National Surety Co. v. Globe Grain & Milling Co.*, 256 Fed. 601, 4 ALR 552, 554.

II.

THE JUDGMENT IS SUPPORTED BY EVIDENCE THAT THE RELEASE WAS INDUCED BY MISTAKE AND WAS NOT A VALID CONTRACT.

A. Plaintiff did not consent to any such release.

The consent of the parties is essential to the existence of a contract. (Cal.Civil Code, §1550.) Consent must be free and an apparent consent is not real or free when obtained through mistake. (Cal.Civil Code, §1565, subd. 1; §1567, subd. 5.)

The gravamen of plaintiff's case is not that the release is a contract which plaintiff assented to in all its terms, but rather it rests on the ground that respondent never consented to enter into any contract releasing all of her claims against defendant; that she was mistaken as to what was meant by the contract; and that this mistake vitiated the entire contract in so far as it related to her physical injuries and made it void *ab initio*. If anything, the release must be construed as a settlement of those matters only as to which the minds of the parties met, and may not be considered to be in satisfaction of anything not consented to by the respondent.

Meyer v. Haas, 126 Cal. 560;

Jordan v. Guerra, 23 C2d 469, 475.

Appellant invokes the rule enunciated in *Greve v. Taft*, 101 Cal. App. 343, 351; and *Palmquist v. Mercer* (1954), 43 C2d 92, 98; yet even these cases recognize that there are exceptions to the general rule cited. Thus, in *Smith v. Occidental*, 99 Cal. 462, 470-471 (cited by the court in *Palmquist v. Mercer*, *supra*, at p. 98), the California Supreme Court stated:

“The general rule is that when a person with the capacity of reading and understanding an instrument signs it, he is, in the absence of fraud and imposition, bound by its contents, and is estopped from saying that its provisions are contrary to his intentions or understanding; but it is also the rule that the assent of a party to a contract is necessary in order that it be binding upon him, and that if the circumstances of a transaction are such that he is not estopped from setting up his want of assent he can be relieved from the effect of his signature, if it can be made to appear that he did not in reality assent to it.”

And, although generally one is presumed to know the meaning of unambiguous language and will be bound by the execution of a written instrument including it, the rule applies only in the absence of fraud, confidential relationship or circumstances indicating excusable mistake.

Reid v. Landon, 166 A.C.A. 573, at 580;

Fraters G. & P. Co. v. Southwestern C. Co., 107 Cal. App. 1;

Wetzstein v. Thomasson, 34 CA2d 554.

Generally, a mistake of fact occurs when a person understands the facts to be other than they are.

Reid v. Landon, *supra*, at 580, and cases cited.

As an example of this see the case of *Nelson v. Meadville*, 19 CA2d 68, at 70, wherein the appellate court stated:

“If the court was satisfied from all the evidence that notwithstanding such examination and reading, the plaintiff did not then understand the terms of the instrument and was not aware that

they provided for the 25 years' instead of the six months' option, it was authorized to find that the agreements were accepted by plaintiff under a mistake in this particular. (Sullivan v. Moorhead, 99 Cal. 157, 160 (33 P. 796).)''

This the trial court has done in this case and has found to its satisfaction that respondent did not understand the terms of the instrument she signed and that she was suffering under a serious mistake of fact which relieved her from the effects of her signature. (See, Findings of Fact, Paragraph V.)

In summarizing these principles, the court in *Union Pacific Co. v. Zimmer*, 87 CA2d 524, 529, stated:

“It is well settled, however, that the mere fact that the release is extremely comprehensive in its terms, and purports to be a complete discharge from all claims arising out of the accident, and is understood as such, by the releasor, it will not prevent its avoidance where proper grounds therefor exist.” (See cases cited at 529.)

B. Proof of a mutual mistake was not necessary.

It is also eminently clear in this State that it is not necessary that the mistake be mutual, in order to vitiate the effect of a written contract. Indeed, the mistake may be unilateral.

Moore v. Copp, 119 Cal. 429, 436;

Palace Hardware Co. v. Smith, 134 Cal. 381, 384;

National Bank of Calif. v. Miner, 167 Cal. 532, 535;

Forest Lawn v. De Jarnette, 79 Cal. App. 601, 604;

Lepper v. Rattener, 98 Cal. App. 245, 255;

Reid v. Landon, 166 A.C.A. 573.

Appellant makes much of the fact that the mistake was not mutual; yet, it is a permissible inference from the evidence in the record to infer that the defendant herself may have believed the settlement was only for the property damage. The record reveals that appellee had an injury to her neck prior to signing the release (Appellant's Exhibit A; R.T. 32); yet not one penny was paid to appellee by appellant for her physical injuries. The court may very well have been warranted in finding that appellant, too, was laboring under a mistake of fact as to what the settlement was intended to embrace. This inference is buttressed by appellant's failure to introduce evidence by her agents concerning their understanding of the contract of release, and by the failure of appellant to contradict in any way the statements which appellee claimed were made to her by her own insurance agents.

C. Whether or not defendant induced the mistake is not determinative.

Appellant also argues at some length that neither she nor her agents had anything to do with the procuring of the contract of release. Appellee has already pointed out that in California the courts have held that the mistake need not be mutual. In addition, it is not necessary that the mistake of one of the parties be induced and the mistake arise from the fraud of the other party.

Moore v. Copp, supra, at 436;

Palace Hardware v. Smith, supra, at 384.

D. Plaintiff was not negligent as a matter of law.

Appellee takes exception to any contention by appellant that appellee may have been negligent in not more fully informing herself of the contents of the written release. Section 1577 of the California Civil Code reads in part:

“Mistake of fact is a mistake, not caused by the neglect of a legal duty on the part of the person making the mistake, and consisting in:

(1) An unconscious ignorance or forgetfulness of a fact past or present, material to the contract.”

In determining what conduct will amount to a neglect of legal duty, the courts recognize that there is an element of carelessness in nearly every case of mistake. (*Van Meter v. Bent Const. Co.*, 46 C2d 588, 595; *Reid v. Landon*, 166 A.C.A. 573, at 579.) As stated by the court in the *Van Meter Case*, at 595,

“... it has been held that ordinary negligence does not constitute the neglect of a legal duty as that term is used in Section 1577 of the Civil Code.”

And, in determining whether a mistake of fact existed, the appellate court must accept as conclusive any decision of the trial court in a factual conflict if there is sufficient evidence in the record to support it. (*Reid v. Landon*, *supra*, at 581.)

Here, the appellee found herself in an unusual position. The release of all claims was procured in this case through the agency of an ostensible friend of the appellee, her insurance agent. She relied in good faith

on what she was told by the agent, and accepted his representations at face value. Whereas in so many cases it is the opposing party who does the negotiating, here it is the trusted confidant who handles the transaction. The rule of wariness which abounds in "arms-length" negotiation is not present in our particular factual situation.

The fact that the appellee signed the release without reading it carefully attests to the lengths to which she was duped. In ruling on a related situation, the Supreme Court of California in *Kane v. Mendenhall*, 5 C2d 749, held that,

"a person signing without reading in reliance on representations in fact false, may avoid an instrument where a confidential relationship exists between the parties."

The courts recognize that in cases involving a fiduciary relationship,

"facts which would ordinarily require investigation may not excite suspicion and that the same degree of diligence is not required."

Hobart v. Hobart Estate Co., 26 C2d 412.

See also,

Stevens v. Marco, 147 Cal.App. 451.

Certainly, it must be found as a logical inference from the evidence that as between appellee and her insurance agent a confidential relationship existed. As a general postulate it is stated that, "Confidential and fiduciary relations are, in law, synonymous, and may be said to exist whenever trust and confidence is

reposed by one person in the integrity and fidelity of another." *Estate of Stover*, 188 Cal. 133, 143. It has been held that the relationship of principal and agent is fiduciary. *Kane v. Mendenhall*, 5 C2d 749, at 759.

E. A release induced by mistake is not valid.

In summarizing, it may be said that the California courts have uniformly gone beyond the four corners of the written instrument of release and relieved innocent parties from the effects of their mistake.

The courts have definitely allowed relief where a release or contract has not been read, but has been signed through mistake, inadvertence or the like.

Jordan v. Guerra, 23 C2d 469;

Mairo v. Yellow Cab Co., 208 Cal. 350;

Davis v. Diamond Carriage Co., 146 Cal. 59;

Palace Hardware v. William Smith, 134 Cal. 381;

Meyer v. Haas, 126 Cal. 560;

Smith v. Occidental, 99 Cal. 462;

Olson v. Olson, 148 CA2d 429;

Matthews v. A. T. & S. F. Ry., 54 CA2d 549;

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Tyner v. Axt, 113 Cal.App. 408;

Foster v. DeVenney, 107 Cal.App. 500;

King v. Globe Grain Co., 58 Cal.App. 105.

In *Reid v. Landon*, 166 A.C.A. 573, a case similar in many respects to ours, the court held that even though

the contract had been read by the defendant she could avoid the effect of her signature on grounds of mistake.

These cases, as well as several of the cases cited by appellant in Part I of her brief, hold that a contracting party may escape the effects of his signature where fraud, mistake or undue influence exists. If mistake as to the nature of the contract does not exist, then appellee could not recover. However, as a matter of fact, the trier of fact has found it to exist and has ruled on this question in favor of appellee.

III.

A TENDER OF THE CONSIDERATION WAS NOT ESSENTIAL.

Appellee did not have to comply with the provisions of the California Code of Civil Procedure relating to rescission of a contract.

In our case, there was little if any dispute as to the negligence of appellant. The trial transcript reveals the following colloquy between the court and appellant's counsel:

"The Court. Let's be frank about it. What do you expect to show from this person in Germany? Are you going to take her deposition? Is there any question about whether this was a rear-end collision?"

Mr. Bruno. No. Here is the only possibility I see: She says that the light was green when she approached the intersection, she saw these folks coming to a stop and assumed that they would

start right up because the light had just changed. She assumed they would go right on after a moment's hesitation, and they didn't, and that caught her unawares. That is about the extent of her testimony insofar as the factual situation is concerned.

The Court. Let's suppose she testified just to that situation. Would that be a sufficient defense to running into the car in front of you? (102)

Mr. Bruno. No, I wouldn't think so, your Honor. I haven't finished.

That was the one possibility, and I feel it wasn't any excuse, probably." (R.T. 103-104.)

Both the appellee and her husband testified as to the nature of the rear-end accident. Even the appellant admitted that she was at fault for this accident. (R.T. 94.)

An examination of the trial transcript reveals that the only possible defense that appellant has to this case is the release signed by appellee. Without it, the court would have had to find almost as a matter of law that the appellant was negligent. Therefore, it must be apparent that a tender of the consideration received for signing the contract, in this case, \$100.00, would be a mere empty act. Appellant would not have accepted such a tender, for without it she was without a defense to the action herein. Under these circumstances, our case must come within one of the exceptions to the requirement of restoration; and that is where the facts are such that it clearly appears that the defendant could not possibly have been injuriously affected by a failure to restore, *Carruth v. Fritch*, 36 C2d 426.

Nevertheless, after a review of the decided authorities in California, it is appellee's position that it is and was not necessary for appellee to tender back the consideration received for the release. The reason for it is that appellee is not attempting to avoid a contract which she has made, but is showing that she did not make the contract which she apparently made. In other words, as far as appellee is concerned, her claim for property damages has been settled to her satisfaction and that is what she believed she settled when she signed the contract of release. At the time of trial she was asserting her claim for physical injuries and medical expenses only. It would be inconsistent to her position in the lawsuit to tender back the consideration received for her settlement of the property damage claim. Cases holding that it is not necessary to offer back the consideration received are:

Jordan v. Guerra, 23 C2d 469, at 476;
Meyer v. Haas, 126 Cal. 560, at 563;
Wetzstein v. Thomasson, 34 CA2d 549;
Tyner v. Axt, 113 Cal.App. 408;
Gajanich v. Gregory, 116 Cal.App. 622.

IV.

THE JUDGMENT IS AN EQUITABLE ONE.

To allow plaintiff and appellee to avoid the consequences of the contract of release would not lead to utter confusion and make a mockery of contract law.

Appellant as part of his argument for Part III of his brief assigns no cases in support thereof. Appellee,

in response thereto, takes the liberty of quoting from a case in many respects similar to ours. In *Denton v. Utley*, 86 NW2d 537 (S.Ct., Michigan, November 26, 1957), in answer to the familiar argument of defendants that the law must favor the strict letter of releases, lest the integrity of all agreements be jeopardized, Justice Smith of the Michigan Supreme Court stated:

“It should neither surprise nor deceive us that the ancient argument comes before us today in modern garb. Where once the courts were admonished, with respect to the law of trusts, to roil not the conscience lest any gentleman in England be presumed out of his entire estate, to disturb not the letter of the conveyance, lest all security transactions be jeopardized, now we are warned to leave untouched the letter of the release, lest no claim ever be settled, and litigation mount. The argument *in terroram* fails here, as it has always failed and for precisely the same reason: We exist solely to do justice and it shall be done.” (At 541.)

Continuing in the same vein, Justice Smith commented:

“If fraud or mutual mistake has induced the making of an unconscionable contract, the court ought to be more concerned about granting relief than desirous of clinching future wrongs by making such contracts uncontestable.” (At 540.)

To summarize Justice Smith’s holding on the point urged by the appellant, the following statement may be made:

(1) The overriding principle is that in the accomplishment of its mission, equity will strike down without hesitation any agreement resulting from oppression, fraud, mutual mistake of the contracting parties, or other evil.

(2) The cases rest upon this great principle, not upon the minutiae urged.

(3) It matters not how sweeping are the words involved in the release.

(4) When their content cloaks inequity, they should be vacated and held for naught.

(5) To put it affirmatively, any release to be sustained must be "fairly and knowingly" made.

See, also,

Rickets v. Penn. R.R. Co., 153 F2d 757 (2d Circ., 1946).

"Generally in this class of cases there is frequently the grossest inequality between the negotiating individuals in native intelligence, education and economic bargaining power . . ."

Cf., Patterson, "Equitable Relief for Unilateral Mistakes," 28 Cal. Law Rev. 859, at 893 (1928).

Apparently, appellant is requesting that this court find as a matter of law that when unilateral mistake exists and when a party is mistaken as to what the contract embraces, he is nevertheless bound by the contract he signs; and, in effect, urges that no matter what the inequity or the harshness of the result, a gullible plaintiff who signs a contract of release is

without recourse, and neither court nor jury may change the result; for the four corners of the paper he signs, its twenty-eight lines, contain all of his rights.

This is the holding which appellant advocates. She is asking this court to give lip service to the rule in California that releases and contracts may be set aside in the absence of fraud and undue influence on the ground of mistake of fact. *Backus v. Session*, 17 Cal. 2d 380, 389; *Graham v. A.T. & S.F. Ry. Co.*, 54 CA2d 549, 552.

It is for this court to decide whether it will deprive the trier of fact of the right to determine on the basis of all the evidence whether an injured party will be relieved of his mistake in signing a release. It is for this court to determine in the final analysis whether it will give vitality, growth and unstilted interpretation to the principles enunciated in the cases of *Meyer v. Haas*, *Smith v. Occidental*, *Wetzstein v. Thomasson*, *Jordan v. Guerra* and the cases cited in Part II, or whether it will stereotype all similar cases which are brought on grounds of mistake.

V.

THE PAROL EVIDENCE RULE DOES NOT APPLY.

The testimony of the appellee as to what she was told about the contract and what she understood it to mean was properly admitted by the trial court.

Section 1856 of the California Code of Civil Procedure states:

“When the terms of an agreement have been reduced to writing by the parties, it is to be considered as containing all those terms, and therefore there can be between the parties and their representatives, or successors in interest, no evidence of the terms of the agreement other than the contents of the writing, except in the following cases:

1. Where a mistake or imperfection of the writing is put in issue by the pleadings;
2. Where the validity of the agreement is the fact in dispute.

But this section does not exclude other evidence of the circumstances under which the agreement was made or to which it relates, as defined in section eighteen hundred and sixty, or to explain an extrinsic ambiguity, or to establish illegality or fraud. The term agreement includes deeds and wills, as well as contracts between parties.”

It is not necessary for appellee to have affirmatively pleaded mistake in order to put in issue the question of mistake at the time of the trial. Code of Civil Procedure §462; *Gajanich v. Gregory*, supra, at 630; *Wetzstein v. Thomasson*, supra at 556. Thus, §1856 of the California Code of Civil Procedure would authorize the court to examine the circumstances surrounding the execution of the release.

Quoting from the court in *Nelson v. Nelson*, 131 Cal.App. 126, at page 135:

“The competency of oral evidence to ascertain the intention of the parties in executing a written instrument is upheld by the text which is found

in 6 California Jurisprudence, page 294, §180, in the following language: 'The rule that the intention of the parties is to be ascertained from the writing alone, where a contract is reduced to writing, is subject to other rules of interpretation. A court is not only to take a contract by all its corners, but it is to be placed in the seats of the parties when it was made. In other words a contract is to be construed in the light and with the knowledge of surrounding circumstances. Section 1647 of the Civil Code provides that, "A contract may be explained by reference to the circumstances under which it was made and the matter to which it relates." ' ' ' "

In addition, California Civil Code §1640 reads as follows: When through fraud, mistake, or accident a written contract fails to express the real intention of the parties, such intention is to be regarded, and the erroneous parts of the writing disregarded. Thus, the question of what is released by a contract of release is open to explanation and elucidation by parol evidence.

See,

Carpenter v. Markham, 172 Cal. 112, 115, and cases cited therein.

And oral evidence to show mistake, fraud, or undue influence may be properly admitted. *Wetzstein v. Thomasson*, *supra*, at 557.

The Supreme Court of the State of California in *Jordan v. Guerra*, 23 C2d 469, at 477, in quoting from *Kansas City, M. & B. Ry. Co. v. Chiles*, 86 Miss. 361, 38 So. 498, said:

“No release of this nature should be upheld if any element of fraud, deceit, oppression, or unconscionable advantage is connected with the transaction. And in passing on the validity of such release, when assailed, all surrounding conditions should be fully developed, and the relative attitudes of the contracting parties clearly shown. So that the jury, in the clear light of the whole truth, may rightly decide which story bears the impress of verity.”

This exception to the general rule is recognized by the cases cited by appellant. See *Guerin v. Kirst*, 33 C2d 402, 410; *El Zarape v. Plant Food Corp.*, 90 CA 2d 336, 344.

CONCLUSION.

Respondent submits that on the basis of all the facts, the rulings of the relevant cases, and the equities, the judgment of the trial court should be affirmed.

Dated, Sunnyvale, California,
February 16, 1959.

Respectfully submitted,

LEWIS, SCHER & FERNANDEZ,
By WILLIAM J. FERNANDEZ,
Attorneys for Appellee.

No. 16054 ✓

IN THE
United States
Court of Appeals
FOR THE NINTH CIRCUIT

THE WASHINGTON WATER POWER
COMPANY, a corporation,

Appellee,

vs.

40 Acres of Land in the East Half, West Half,
Southeast $\frac{1}{4}$ of Section 24, Township 45,
North, Range 5, Idaho, JULIA NICODE-
MUS; R. H. SPENCER; THE UNITED
STATES OF AMERICA; and Unknown
Owners,

Appellants.

No. 16054

Brief of Appellee

*On Appeal from the United States District Court
District of Idaho, Northern Division*

JOHN HUNEKE
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Of Spokane, Washington

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FILED

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Attorneys for Appellee

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STATEMENT OF JURISDICTION

1. (a) Appellee, as plaintiff below, alleged jurisdiction of the United States District Court, based on the Act of March 3, 1901, c. 832, #3; 31 Stat. 1084, Title 25 U.S.C. 357, as follows:

“Lands allotted in severalty to Indians may be condemned for any public purpose under the laws of the State or Territory where located in the same manner as land owned in fee may be condemned, and the money awarded as damages shall be paid to the allottee.” (This will be referred to throughout the brief as the Act of 1901.)

(b) The jurisdiction of the United States Court of Appeals, although not stated by appellant, must be based on the Act of June 25, 1948, c. 646, 62 Stat. 929; Title 28 U.S.C.A. 1291, which is in part as follows:

“The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States.”

and on Idaho Code condemnation section 7-704 as follows:

“Before property can be taken it must appear:

1. That the use to which it is to be applied is a use authorized by law.
2. That the taking is necessary to such use.
3. If already appropriated to some public use, that the public use to which it is to be applied is a more necessary public use.”

The order questioned in this appeal is based on this last section of the code and is one interpreted by the Idaho courts as being *in limine* and appealable. (See *McLean v. District Court* 24 Ida. 441; 134 Pac. 536.)

2. Appellant's appeal challenges the validity or effect of the Act of 1901 referred to above, in light of a treaty ratified March 3, 1891 between the United States Government and the Coeur d'Alene Indians, Vol. 26 U. S. Statutes-at-Large, 51 Congress, p. 1028, quoted by appellant's counsel. (Br. 1, 2) (This treaty will be referred to throughout the brief as the Treaty of 1891.)

3. (a) Appellee, as plaintiff, alleged the jurisdiction of the Federal District Court in paragraph II of its complaint (Tr. 1).

(b) The United States District Court entered its Order of Use and Necessity and Appointing Commissioners (Tr. 28-31) to which the defendant Julia Nicodemus filed a motion for new trial, which motion was denied by the District Court in an order signed February 8, 1958 (Tr. 55-56). Defendant Julia Nicodemus served and filed a notice of appeal on March 6, 1958 to the United States Court of Appeals.

STATEMENT OF THE CASE

The Washington Water Power Company, appellee and plaintiff below, brought an action in the United States District Court for the District of Idaho, Northern Division, to condemn an easement for construction of a 230 KV electric transmission line across a portion of a certain 40 acres of land held by the United States in trust for Julia Nicodemus, an allottee Indian (Tr. 1-5). The United States, Julia Nicodemus and R. H. Spencer, a farmer tenant of the property, were all joined as defendants.

After a hearing at which all parties were represented, the District Court entered its Order *in limine*, as to use and necessity, and appointing commissioners (Tr. 28-31) in accordance with Idaho Code 7-704 (*supra*). To that order, defendant Julia Nicodemus interposed a motion for new trial which was disposed of by the order denying the motion (Tr. 55-56). Notice of appeal followed, raising as an issue the validity of the court's Order. Appellant contends the entry of such order was error, although the assignment of error refers to a motion to dismiss respondent's complaint.

Regardless of the assignment of error (Br. p. A) or the points on which appellant relies as filed herein, the sole legal question involved in this appeal is whether, in light of the Indian Treaty of 1891, and after tribal lands, with consent of the Indians, were allotted in severalty, the District Court was authorized to allow condemnation of an easement across such allotted lands under the act of 1901 and procedures set out in the Idaho condemnation statutes. Appellant argues that the District Court did not have that authority, and appellee contends that the court did have such power and that the order was properly entered.

SUMMARY OF ARGUMENT

Appellee submits:

I. that the condemnation for the easement is not contrary to the Indian Treaty of 1891; as it does not interfere with possession nor take any of the fee;

II. that the restrictions of the Treaty of 1891 no longer apply, because the Indian reservation has since been broken

up under the General Allotment Act; and

III. that the condemnation Act of 1901 allows condemnation for public purposes, only and specifically across allotted Indian lands, despite the earlier treaty concerning reservation lands; and that the procedure to be followed in such condemnation is set out in the statutes of the particular state in which lands are situated.

ARGUMENT

I.

The Indian Treaty of 1891 (*supra*) in using the words, "no part of said reservation shall ever be sold, occupied, open to white settlement or otherwise disposed of without the consent of the Indians residing on said reservation,"

did not specifically deny the right of condemnation for the purpose of acquiring an easement for construction of an electric transmission line. Appellee contends the treaty did not contemplate that the taking of such an easement would violate its terms. Under this view the treaty has not been violated by the condemnation, and such condemnation is proper.

II.

Even more persuasive, however, is the fact that the status of the lands has changed from tribal lands to lands held in severalty, and Julia Nicodemus in accepting an allottee Indian's patent to specific lands now has land to which the treaty no longer applies.

A chronological statement of events emphasizes this

fact. First, the Government under Executive Order of November 8, 1873 (Br. 2) set aside certain lands as tribal lands for a Coeur d'Alene Indian reservation. This was followed by the Treaty of 1891 (*supra*) agreed to on March 26, 1887 (Br. 1), providing for payments to the tribe and including the provision against disposition of the tribal lands relied on by appellant's counsel in their brief (Br. 1, 2). Subsequently, this Coeur d'Alene Indian reservation was broken up and, with consent of the Indians, the tribal land therein opened to settlement and allotted under the General Indian Allotment Act (Title 25 U.S.C.A. #331, Act of Feb. 8, 1887, c. 119, par. 1, 24 Stat. 388; Act. of Feb. 28, 1891, c 383, par. 1, 26 Stat. 794; amended June 25, 1910, c. 431, par. 17, 36 Stat. 859). Under this act, Julia Nicodemus received allotment No. 80, Coeur d'Alene Indian reservation, and patent was issued to her, subject to the usual statutory restrictions and provisions, and reserving title in the United States in trust.

Under these circumstances there is no longer any reservation or tribal land, and no land to which the treaty can apply. By taking allotments, the Indians, and Julia Nicodemus, have consented to a break up of the reservation and the time for relying on the treaty has long since expired. If there is any violation of the treaty, it is the taking under the Allotment Act, not condemnation under the Act of 1901. The status of the property has changed from a tribal Indian reservation to settled land devoted to farming by the allottee Indians individually, and not the tribe. An allottee Indian can not now complain about disposition of reservation land. The Act of 1901 applies by its terms only to lands

allotted to Indians and it can not apply to an Indian reservation. In *U. S. vs. Oklahoma*, 127 F. (2d) 349, the Court said:

“Obviously, the power to condemn lands allotted in severalty to an individual Indian did not extend to Indian reservations, tribal lands, national forests, and other lands under the exclusive jurisdiction of the federal government. As to these lands, only the power to permit the use of a right-of-way under varying forms and conditions was authorized. * * * Land allotted in severalty is no longer part of the reservation nor is it tribal land; the virtual fee is in the allottee with certain restrictions on the right of alienation. *United States v. Minnesota*, 113 F. (2d) 770.”

Because of the importance of setting the difference between reservation land and allotment land, the Supreme Court granted certiorari and this decision was affirmed in 318 U. S. 206; 87 L.Ed. 716, 63 Sp.Ct. 534. This answers many of the authorities in appellant's brief referring to encroachment on tribal lands (Br. 6-7).

III.

The principal question raised by appellant's counsel in their brief is whether an act of Congress, which counsel claim abrogates the terms of a prior treaty, should be followed by the court under the circumstances in this case. Appellant's counsel concede that Congress has the right to abrogate prior treaties with the Indians by later enactments (see citation from *Lone Wolf vs. Hitchcock*, 187 U.S. 553, Br. 3, 4) but state that such should not be followed here as this condemnation is not for the Indian's benefit. The only ground mentioned by appellant's counsel as to why it is

not for the Indians benefit, is that it violates the treaty right and as Congress has that right, appellant's counsel seem to be arguing in a circle.

Congress can, by legislative enactment, abrogate existing treaty rights. The United States retains sovereignty over Indian lands even after a treaty is signed, or the land allotted, and condemnation over such lands may be allowed by Congress even if it should abrogate a prior treaty. One of the latest pronouncements of this principle is in the case of the *Sioux Tribe of Indians vs. The United States*, 146 Fed. Supp. 229 (1956) in the Court of Claims wherein the court stated as follows:

"While it had been the practice and policy of the United States Government during the many years of tension between the whites and the Indians to negotiate with them by treaty convention and to settle differences, if possible, by treaty, those treaties did not absolutely abrogate the right of the government to regulate the Indians or, when necessary, to legislate contrary to or inconsistently with a treaty."

The Court also quoted with approval from *Lone Wolf v. Hitchcock* (*supra*) and also quoted the following from *Choate v. Trapp* cited by appellant's counsel (Br. 5).

"The Supreme Court, in *Choate v. Trapp*, 1912, 224 U. S. 665, 671, 32 S. Ct. 565, 567, 56 L. Ed. 941, while speaking on this subject, stated as follows:

"* * * the plenary power of Congress over the Indian Tribes and tribal property cannot be limited by treaties so as to prevent repeal or amendment by a later statute. The Tribes have been regarded as dependent nations, and treaties with them have been looked upon not as contracts, but as public laws which could be abrogated at the will of the United States.'"

While appellant's counsel apparently concede this general principle of law, they then grasp at various straws and raise certain inferences attacking the procedure in this case. These inferences should be answered.

Inference (a). Appellant's counsel contend that this condemnation is not in the best interest of Julia Nicodemus because she is not a stockholder in the appellee company. The condemnation is not for the benefit of the stockholders. Obviously, it is for the benefit of the public, including Indians, and condemnation is allowed for that reason. The company is a public utility engaged in the transmission of electric current for the benefit of the citizens of Idaho, whites and Indians alike, regardless of their status as stockholders. The use of electricity by the general public and its transmission is in the general interest. The 1901 Act in allowing condemnation for public purposes carries out such right for the benefit of the public as a whole, not for any particular group or company. The general public, including whites and Indians and Julia Nicodemus are benefitted by the transmission of electricity. The District Court in the Order of Use and Necessity decreed as follows:

"The plaintiff is a public utility corporation lawfully doing business in the State of Idaho as a public utility in the distribution of electric energy to the public and is duly authorized by law to exercise the right of eminent domain in the State of Idaho under and by virtue of Section 7-701 of the Idaho Code.

"That the easement and rights sought to be acquired and appropriated by the plaintiff are necessary to the discharge of the public duties of the plaintiff and are necessary to the construction, use and maintenance and reconstruction of its power transmission line and that the taking of the land and property of the defendant sought to be acquired for such use." (Tr. 29)

Appellee submits that the authorities cited on page 5 of appellant's brief are not in point as they refer to different situations than condemnation, and do not sustain appellant's position. Certainly the general public good must be considered as justifying the application of the condemnation statute to this situation.

Inference (b). Appellant's counsel next suggest that the proper procedure was not followed in that plaintiff failed to obtain permission of the Secretary of the Interior before going ahead with the condemnation action. Appellee points out that the statute provides for two separate courses of action, either a permit from the Secretary of the Interior for erection of a transmission line, or by pursuing a condemnation action without seeking such permit. This difference has been clearly pointed out in *United States vs. State of Minnesota*, 113 F. (2d) 770 (1940):

"The land involved is a tract of allotted Indian land held in trust by the United States * * *.

"The question involved is whether the State may by virtue of Section 3 of the Act of March 3, 1901, 25 U.S.C.A. #357, maintain this proceeding to condemn an easement over the allotted land for the establishment of a public highway, without having first secured from the Secretary of the Interior permission for the opening and establishment of such public highway through allotted Indian land, as provided by Section 4 of the Act of March 3, 1901, 25 U.S.C.A. #311. * * *

"The statutes seem definitely to offer two methods of procedure for the acquisition of a right of way for public highway. Section 3, 25 U.S.C.A. #357, authorizes the maintenance of condemnation proceedings.

* * *

"By Section 4 of the Act, 25 U.S.C.A. #311, the Secretary of the Interior is authorized to grant permission

for the opening and establishment of a public highway through lands allotted in severalty. Thus, it was made possible to acquire such a right of way by either of two methods, the Government having consented to each of these methods."

Appellee submits that the proper procedure was followed in this instance.

Inference (c). Appellant's counsel inferentially complain that the Government should have vigorously contested the action and did not do so. Appellee concedes that the United States is a necessary party to the action and it was made a defendant. It is also clear that in a case involving the Act of 1901, the consent of the United States to suit is implied.

"It is true that authorization to condemn confers by implication permission to sue the United States." *Minnesota vs. The United States*, 305 U. S. 382 at 388, 83 L. Ed. 235 at 241. 59 Sp. Ct. 292.

The Government appeared by the United States Attorney, he was present at the hearing, has taken an active part throughout the law suit, and procured an appraiser of the Indian Agency who furnished proof on the amount of damages in the hearing before the Commissioners. The Government attorney complied with all the necessities and has only followed a long established administrative practice in allowing such condemnation across Indian allottee lands. See *United States vs. Minnesota*, 113 F. (2d) 770.

"The administrative officers of the Government, charged with the administration of this Act, have consistently construed it as authorizing the condemnation of allotted lands without the consent of the Secretary

of the Interior. The Department of the Interior, in its booklet entitled 'Regulations of the Department of the Interior Concerning Rights of Way over Indian Lands,' published in 1929, pointed out the various laws applicable to the granting of rights of way through Indian lands, tribal and allotted, and gave direction for procedure. Sections 68, 69 and 70, under the heading of 'Condemnation of Allotted Lands,' provide:

"'68. The condemnation of allotted Indian lands for any public purpose in accordance with the laws of the State wherein the lands are situated is authorized by the last paragraph of section 3 of the Act of March 3, 1901 (31 Stat. 1, 1058-1083-1084).

"'69. Any project for which private lands could be condemned under State laws is held to be a public purpose within the meaning of the Act of March 3, 1901, above cited.'"

Inference (d). Appellant's counsel also argue by inference that the Act of 1901 allows a State to condemn Indian land. The Act only provides the rules and procedures under which such condemnation shall be allowed across allotted Indian lands. Congress has provided that as a Federal matter and in Federal Courts and with the United States as a party, condemnation of allotted lands may be had for any public purpose, and then provides that the action shall proceed in accordance with the Laws of the State where the property is located, and with the money paid to the allottee. The wording of the act above quoted in full seems to answer this argument under which appellant complains that certain rights have been surrendered to the States. Appellee contends that these rights are held under the control of Congress at all times and that the procedure, for purposes of convenience, are set in accordance with state statutes, provided that the action is carried on in the federal courts.

CONCLUSION

Appellee appreciates the fact that Julia Nicodemus does not want a portion of her land condemned for this purpose. This is true generally of defendants in condemnation actions. On occasion the public good requires stepping on individual toes. Such situations brought about the necessity of providing for condemnation actions for public purposes.

If Julia Nicodemus had fee title to the property without any interest being retained in trust by the United States, her land would clearly then be subject to condemnation. The Act of 1901 extends such right to United States lands held by Indians under allotment. In such circumstance, Julia Nicodemus should have no greater rights than anyone holding full fee title. The Act of 1901 recognizes this in using the words "in the same manner as land owned in fee may be condemned." Any prior treaty rights can not give any greater rights than she would have in the event she owned fee title. The Treaty of 1891 can not forever insulate that property against all public use, and especially does not do so when tribal land has been broken up in allotments and when Congress has provided that condemnation may then be had. It is appellee's position, which has been sustained by the Federal Courts, that Congress has provided for condemnation of allottee's land by the Act of 1901, and

that the prior treaty can not take away any of such authority. The District Court order should be affirmed.

Respectfully submitted,

JOHN HUNEKE

W. F. McNAUGHTON

Attorneys for Appellee

PAINE, LOWE, COFFIN AND HERMAN

McNAUGHTON & SANDERSON

Of Coeur d'Alene, Idaho

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for the Ninth Circuit**

NICODEMUS, APPELLANT

v.

WASHINGTON WATER POWER COMPANY, APPELLEE

**UPON APPEAL FROM THE UNITED STATES DISTRICT COURT OF
IDAHO, NORTHERN DIVISION**

BRIEF FOR THE UNITED STATES, APPELLEE

PERRY W. MORTON,
United States Attorney,

BEN PETERSON,
*United States Attorney,
Boise, Idaho.*

ROGER P. MARQUIS,
*Attorney, Department of Justice,
Washington 25, D. C.*

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In the United States Court of Appeals for the Ninth Circuit

No. 16054

NICODEMUS, APPELLANT

v.

WASHINGTON WATER POWER COMPANY, APPELLEE

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT OF
IDAHO, NORTHERN DIVISION

BRIEF FOR THE UNITED STATES, APPELLEE

OPINION

The district court did not write an opinion.

JURISDICTION

This is an appeal filed March 6, 1958, from an order awarding possession after determination of just compensation in a condemnation case. A motion for new trial was denied on February 7, 1958. The jurisdiction of the district court was invoked under 25 U. S. C. sec. 357, as construed in *Minnesota v. United States*, 305 U. S. 382 (1939). The jurisdiction of this Court is invoked under 28 U. S. C. sec. 1291.

QUESTION PRESENTED

Whether Congress has constitutional power to authorize the condemnation of land allotted to an Indian.

STATUTE INVOLVED

Section 3 of the Act of March 3, 1901, 31 Stat. 1084, 25 U. S. C. sec. 357, provides, in part, as follows:

Lands allotted in severalty to Indians may be condemned for any public purpose under the laws of the State or Territory where located in the same manner as land owned in fee may be condemned, and the money awarded as damages shall be paid to the allottee.

STATEMENT

This proceeding was instituted by the Washington Water Power Company in June 1957 to condemn an easement for a transmission line over a designated 40-acre tract of land in Idaho. The tract constitutes lands of Julia Nicodemus, a restricted Coeur d'Alene Indian. The United States filed notice of appearance while the Indian by answer denied authority to condemn.¹ The authority was upheld and, pursuant to Rule 71A¹ (k) and Idaho law compensation was determined by commissioners, the amount awarded was paid into court, and possession was awarded to the company. Objection to the taking was reiterated by motion for a new trial which was denied on February 7, 1958, and this appeal followed.

¹The Company moved to strike appellant's answer on the theory that under 25 U. S. C. sec. 175 only the United States Attorney could represent the Indians. We assume that contention will not be urged here since the statute is plainly permissive, not mandatory. *Siniscal v. United States*. 208 F. 2d 406 (C. A. 9, 1953).

ARGUMENT

Condemnation of appellant's land was properly authorized by Congress

In the last few years Indian Tribes have on several occasions contested the condemnation of their lands either for various federal projects or for projects of licensees under the Federal Power Act. These attacks have failed with one possible exception. *Seneca Nation of Indians v. Brucker*, C. A. D. C., November 18, 1958,² affirming 162 F. Supp. 580; *Tuscarora Nation of Indians v. Power Authority of the State of New York*, 257 F. 2d 885 (C. A. 2, 1958), cert. den. October 13, 1958, No. 384; *United States v. 5,667.94 Acres of Land, Etc.*, 152 F. Supp. 861 (D. Mont. 1957); *United States v. 21,250 Acres of Land*, 161 F. Supp. 376 (W. D. N. Y. 1957). The one exception was a case where condemnation proceedings were dismissed and appeal was taken. Pending appeal Congress settled the matter and the judgment was vacated and the case dismissed as moot. *United States v. Sioux Indians of Standing Rock Reservation*, 259 F. 2d 271 (C. A. 8, 1958). All of these cases recognized the well settled power of Congress, in connection with the administration of Indian Affairs, to authorize the condemnation of tribal or allotted lands regardless of the treaty provision that might otherwise be applicable. See *Cherokee Nation v. Southern Kansas Railway Co.*, 135 U. S. 641, 657 (1890); *Henkel v. United States*, 237 U. S. 43 (1915). Specifically, as to section 3 of the 1901 Act here involved, the court in *Minnesota v. United States*, 305

² Copies of this unreported opinion are submitted herewith.

U. S. 382 (1939) held that allotted lands could be condemned by the State in federal court upon joinder of the United States. The result is the same whether the United States holds the fee title in trust for the allottee or the allottee has title subject to restraints on alienation, footnote 1, 305 U. S. at p. 386. There can thus be no question of the validity of the 1901 Act.

Appellants attempt to invoke *United States v. Forty-three Gallons of Whiskey*, 108 U. S. 491 (1883); *Elk v. Williams*, 112 U. S. 94, 100 (1884) and similar cases (Br. 4-6). It was decisions such as these upon which the Indian Tribes relied in the cases cited above to support their argument that legislation under which the condemnation of lands of private persons was authorized was not sufficient to authorize the taking of Indian tribal lands. It was the position of the United States that no special form was necessary to authorize acquisition of Indian lands but that such lands, tribal or allotted, were subject to the same principles as all other lands. But even if, for purposes of argument only, it is assumed that there is some special rule of construction applicable to Indian statutes, the 1901 Act is perfectly plain and unambiguous. There is no possible construction which would exempt appellant's lands from condemnation. "Though statutes terminating Indian property rights should be construed narrowly, we cannot ignore the intention of Congress where it is perfectly plain." *United States ex rel. the Shoshone Indian Tribe v. Seaton*, 248 F. 2d 154, 155 (C. A. D. C. 1957), cert. den. 355 U. S. 923.

Appellants apparently argue (Br. 7-8) that the United States is an express trustee and as their guard-

ian could authorize condemnation only upon a showing that it is in their best interests. But, since Congress has spoken so explicitly, there is no occasion to discuss whether or not the 1901 Act was for the best interests of allottees. It should be noted, however, that while the relationship of the United States with the Indians has been said to resemble that of guardian and ward, "It is clear that this relationship does not exist between the United States and the Indians, although there are important similarities and suggestive parallels between the two relationships." *Federal Indian Law*, Department of Interior, 1958, p. 557; *Sioux Tribe of Indians v. United States*, 146 F. Supp. 229, 237-238 (C. Cls. 1956).

CONCLUSION

It is submitted that the judgment below should be affirmed.

Respectfully submitted.

PERRY W. MORTON,
Assistant Attorney General.

BEN PETERSON,
United States Attorney,
Boise, Idaho.

ROGER P. MARQUIS,
Attorney, Department of Justice,
Washington 25, D. C.

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